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ACCOUNTING

PRINCIPLES AND PRACTICE

BY

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PREFACE

The present volume is the second of a series on accounting, and continues the work covered in Accounting: Principles and Practice, Volume I, which was published toward the end of the past year.

Volume II covers the second semester work of the first year of a collegiate course in accounting. It presents briefly in fifteen chapters, with questions and problems, the principles underlying record construction, accounting for partnerships, branches, consignments, and joint ventures, and the control of manufacturing records on the general books.

Since the author has outlined in considerable detail, in the first volume of this series, his aims and purposes in the presentation of the material covered in both volumes, it is necessary merely to add here that Volume II has been prepared with these ends in view, and is in every way a direct continuation of Volume I.

George E. Bennett.

614 Cahill Building,
Syracuse, New York,
January 20, 1921.

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ACCOUNTING
PRINCIPLES AND PRACTICE

CHAPTER I

ACCOUNT CLASSIFICATION

§ 1. Internal Checks and Balances

Every employer owes each of his employees an opportunity to be honest. His accounting system should be such that an employee can be guilty of dishonest practices only with the greatest difficulty. Every employee should favor all methods and safeguards helping him in this connection; not so much because it protects the "boss" as because it will protect himself from being held responsible for something he did not do—of which not guilty. An accounting system, properly organized, should work both ways in this respect,—as a protection for the employer and as a safeguard to the employee. In other words, an accounting system should minimize the chances for dishonesty, and should be such that, if dishonesty be practiced, it will at once be detected.

One method of securing proper accounting control is to divide duties so that fraud cannot be committed without collusion between a number of employees. One person may sell; a second may collect and make change for the sale; and a third may record the cash so collected. The one who handles the cash should never have access to the customers' and creditors' Ledgers. The individual who makes a credit sale should never be permitted to receive cash, ship out the goods, or keep the cash record. Employees should be required to exchange duties occasionally; and in this connection, vacations should be insisted upon at least once a year.

No one person should be permitted exclusively to handle the materials and supplies. The purchasing agent should not be required to handle the issue of stock; to do so, will open an avenue, over a long period of time, for the peculation of large quantities of goods. Again, the purchasing agent should not be permitted, upon his own initiative, to place an order; some other person should authorize its placement.

The illustrations may be continued indefinitely. However, in the following chapters on the subject of constructive accounting, the principles of internal check will be further expounded in connection with specific phases of accounting activity. The point to bear in mind is that all internal checks and balances should be automatic, and not forced. They should be part of the regular routine procedure, and not operate only at will. For example, if a man needs exercise, he may force himself to go to a gymnasium certain times each week. It would be much better for him, however, to secure his exercise in some more agreeable fashion; he could arrange to walk, perhaps, to and from his business each day. By so doing, exercise would be taken automatically and without forced effort on his part.

§ 2. Adequacy of an Existing System

Each business is a problem unto itself; it is a case with particular needs and, as such, a system of accounting should be developed therefor to meet these requirements. An accounting system of merit is one which is accurate, rapid in operation, and which supplies the information desired and needed. No matter what form records may take, what books are used, whether certain books are in balance or out of balance,—if the system in use satisfactorily serves the purpose for which it was installed, it is a good system.

Every system requires a central control. The work done and handled should follow a wasteless routine procedure impossible of change except upon approval and authority. Bookkeepers should secure everything they are to record and need without waste of effort or time.

All records should be constructed in a simple manner, possible of being interpreted readily by persons who do not work on them. The manager should understand his system of account-keeping as well as his bookkeeper. Every system should not require an expert to interpret it. Simplicity and, again, simplicity!

Record keeping should be automatic. One operation should be done at a time. When a bookkeeper posts, he should post, and do nothing else at that time; he should concentrate on one thing, complete that and pass to another. The system he is working with should permit this to be done.

§ 3. Labor Saving Devices

Roughly speaking, labor saving devices consist of both methods and materials,—the intangible and the tangible. With methods, one refers primarily to the organization system permitting work to be turned out rapidly and accurately—the system of internal check. With materials, one refers to such things as books, forms, accounts, ledgers, records of original entry, and machinery.

Labor saving devices are many, as indicated above, comprising all things used to speed up work and reduce man's personal effort. Loose leaf records are described later. It may be advantageous to use loose leaf records and, again, it may not; circumstances alter cases. Card records may even be more satisfactory than loose leaf records in sheet form; again, they may not. Original records may take the form of tickets, vouchers, or loose sheets (duplicate copies). The voucher system may be

used. Original records and ledger forms are ruled in many ways to assist in accumulating information rapidly and accurately. All of these various devices will receive proper attention in the following chapters.

§ 4. Constructive Accounting

It has been stated already that the science of accounting may be divided into three branches:

1. Recordative
2. Constructive
3. Analytical—Auditing

The recordative branch concerns double entry, its theory and practice. Constructive accounting deals with the construction of

1. Account classifications
2. Ledger records
3. Records of original entry
4. Statements

Analytical accounting or auditing concerns the analytical side of the science, the verification and analysis of accounting records and statements.

The first part of the present course discusses the principles of constructive accounting, and ends with a consideration of certain accounting fundamentals based upon the recordative principles already presented in Course No. 1.

On the whole, it seems impossible to differentiate clearly the first two branches of accounting, one from the other, because they overlap one with the other. A person must understand the recordative branch in order to construct accounting records properly, and an understanding of the first two branches is necessary to a proper knowledge and application of the third. Auditing is a study of the analysis of records and statements

in the light of the principles of accounting, both elementary and advanced. The accountant constructs the system, the bookkeeper does the mechanical work of operating the system, and the auditor, who should be an experienced accountant, interprets and criticizes the work done by the bookkeeper.

§ 5. Basis for Record Expansion

In constructive accounting, to which attention will be directed during the next four or five chapters, books and records, forms and statements, are devised and developed according to the needs of a particular business to put into satisfactory operation the theory of double entry.

The larger the business, the more detailed the information required from the accounting records. This makes necessary a large force of bookkeepers with a resultant division of records so that all may work on them at the same time without interference. As the bookkeepers increase in number, requiring the gradual subdivision of a few records into many, the general trial balance is no longer a sufficient check upon the accuracy of the postings made. This need for a better check and for an elimination of excess labor has caused a two-way development:

1. The introduction of the controlling account. (For complete discussion, see Course No. 1.)
2. The use of the columnar Journal to reduce the number of postings to the ledger.

Tied in with this two-way development are found the major divisions of constructive accounting as mentioned in the last section. Account classifications, ledgers, and statements form one complete whole, and records of original entry form a second. Account classifications must be studied in detail so that the controlling account expedient may be made use of properly whenever possible; the

accounts thus determined upon must be placed upon the ledger; and the statements required must be kept in mind as account classifications and ledgers are evolved.

When the account classification and the ledgers have been determined upon, the original records must be constructed in the light of assembling facts in the first instance in the best way possible to secure the smoothest flow of said facts from such records into the accounts carried upon the Ledger and from thence into the statements which set out the results of the facts thus gathered together.

Since the purpose of any system of accounts is to secure a correct Balance Sheet and Statement of Profits and Income, the development of the subject of constructive accounting logically seems about as follows:

1. Account classification
2. Ledger records
3. Records of original entry
4. Statements

And in this way the study of constructive accounting will be approached in the present course.

It should be kept in mind that there is a correlation between these four distinct parts of constructive accounting. Fundamentally, there must be the determination of the account classification. Such classification, as a rule, will determine the ledger arrangement and the columnarization of the records of original entry. Likewise, in both detail and summary form, the account classifications should agree with the determined-upon statement classification; if not, a considerable amount of waste effort will be encountered in ledger account analysis whenever statements are to be prepared in order to secure the desired statement figures.

§ 6. Account Classification: Usual Division

In single entry, accounts are kept with persons only. All other accounts are considered in the nature of memoranda. In other words, in single entry, accounts are not kept with all elements of a business. In double entry, accounts are kept with all elements of a business, more or less in detail, as desired. This is because every debit and credit must offset its equivalent credit and debit. As a rule, when a person is debited or credited, the equivalent is not a person, but representative of some element of the business, as:

Account receivable (person)
  To—Merchandise

Based upon the above reasoning, many writers classify accounts as personal and impersonal, the impersonal accounts, in turn, being divided into real accounts and nominal accounts.

1. Personal. These pertain to persons, debtors or creditors.
2. Impersonal. These pertain to all accounts not personal.
    a) Real. Real accounts represent:
        i. Assets. Assets have intrinsic value and can be sold if necessary. These assets are other than accounts receivable—debts due from persons.
        ii. Liabilities. Liabilities represent obligations which must be paid. They are other than debts due to persons—accounts payable.
    b) Nominal. Nominal accounts represent operating or trading costs, or income. Eventually, they disappear into the Profit and Loss account.

§ 7. Account Classification: Logical Division

The above classification of accounts is criticized because it fails to specify the character of the personal accounts as real or nominal. Therefore, the above classification should be revised to eliminate this possible objection. If accounts are classified first into real and nominal accounts, and then the real accounts subdivided into personal and impersonal, the objection above indicated will be eliminated.

1. Real
   a) Personal—customers, creditors
   b) Impersonal—land, buildings, etc.
2. Nominal
   a) Impersonal—expense, salaries, income, etc.

All personal accounts are shown clearly to be real, and the impersonal accounts to be either real or nominal. This distinction is important if accounting records are to record true conditions—real assets and liabilities against facts which are only nominal.

§ 8. Name of an Account

The name of an account in a classification should be as accurate as it is possible to make it. Yet, the purpose for which an account is used should govern the making of the bookkeeping record. The Freight account, for example, would not hold items connected with freight on a piece of machinery purchased for operative purposes in a factory.

The big problem in account classification is to know just when to stop classifying and sub-classifying transactions in order to prepare a satisfactory chart of accounts. The more detailed a classification is made, the more minute becomes each sub-classification, and the more minute the sub-classification the more nearly cor-

rect will the name of an account reflect and describe the items to be contained thereunder.

§ 9. Determining Account Classifications

In determining upon account classifications, one decides what accounts are to be used and defines the kind of transactions to be recorded in each account, this being dependent upon the accounting needs of the organization in question—its size, and the probable volume of transactions handled. The Ledger contains the accounts which have been determined upon, so that the debits and credits involved in and connected with the business transactions may be collected properly in order that later they may be used for statement purposes.

When deciding upon a classification of accounts, the forms which the two basic accounting statements are to take—the Balance Sheet and the Statement of Profits and Income—should be considered carefully. The ledger records collect financial facts which in the first instance have been recorded chronologically in records of original entry. These facts as recorded in the ledger are taken and used in the construction of statements. When recorded in records of original entry, they are therein set out in accordance with the classification of accounts agreed upon. Therefore, to insure the proper working of a system of accounts, the classification agreed upon must be selected both in the light of the statements later to be prepared from the ledger and in the light of the original records which are to hold the debits and credits temporarily before they are posted to the Ledger or Ledgers.

§ 10. Financial Position Versus Progress

Account classifications set out both the financial condition of a business and its economic progress. The ac-

counts reflecting financial position divide themselves into two opposing groups, one of which records assets, and one of which records liabilities. The accounts reflecting progress, likewise, divide themselves into two opposing groups, one recording income and one recording expenses.

In connection with the above division and grouping of accounts, it must be remembered that certain accounts may have a mixed character. A Machinery account at the end of an accounting period will contain the nominal element of depreciation merged in with the real element. On the other hand, a nominal account like Interest at the end of an accounting period may contain a real element. The adjustment of these accounts has been explained already in Course No. 1.

Also, certain other accounts, like the proprietor's Capital and Personal accounts, Profit and Loss account, and Reserve accounts, do not fit into the basic classification set out above. No difficulty should be experienced, however, if the basic classification is considered as dividing all accounts into those which pertain to the Balance Sheet and those which pertain to the Statement of Profits and Income.

§ 11. Classification Methods

The classification and sub-classification of accounts should proceed from that which is general to that which is particular and detailed. The more detailed a classification, the more particular will be that classification.

"Income" is a generic term including all kinds of income. "Expense" is a generic term including all kinds of expense. If an account called "Expense" is used, all expense items would be gathered into it which cannot be merged into a specific Expense account. Illustration of this principle need not be carried further.

Accounts may be classified according to the parts which make up a complete organization. The Sales account, for example, collects all sales income indiscriminately. If the organization is departmentalized there may be a Sales account for each department. Accounts may be constructed in part or whole upon a geographical basis, as would be the case in a gas company, in which customers' accounts are sometimes grouped by districts of a city or by streets. A milk company may classify its sales and customers by routes.

Again, customers' accounts may be grouped alphabetically. This was illustrated early in Course No. 1, in the chapter on controlling accounts. Accounts, also, may be grouped numerically, as in a concern which ships on consignment; each shipment is given a number. Such a grouping would be used in connection with some other. Lastly, accounts may be grouped in the order in which they occur; in other words, chronologically.

As a rule, combinations of the above groupings will be used, one or more, depending upon the business under consideration, and its activities.

Whatever may be the classification, it should give the necessary and required amount of information for proper and effective control as considered from the managerial point of view; it should not be too minute in character because, if so, each account will not hold many entries during an accounting period. It should conform as much as possible to the wishes of the management, because the management is the party to be satisfied; and it should be of such detail that the maintenance cost of keeping the classification will not be greater in proportion than its usefulness.

§ 12. Schedule or Chart of Accounts

When a classification of accounts has been worked out, the results should be assembled into a schedule in which each account is set down, and in which the purpose of each account is contained in a short accompanying paragraph; the latter should include, also, in outline form the classes of items to be debited and credited thereto. This chart is to be the bookkeeper's working guide. The accounts when placed upon the schedule or chart are usually gathered into two major groupings,—those pertaining to the Balance Sheet and those pertaining to the Statement of Profit and Loss. Fundamentally, the basic division will be about as follows:

1. Assets
2. Liabilities
3. Proprietorship
    a) Vested-Investment
    b) Temporary
        1. Income
        2. Expense

The above grouping may be shown as follows:

A. Balance Sheet accounts
    1. Assets
    2. Liabilities
    3. Investment
B. Profit and Loss accounts
    4. Income
    5. Expenses

§ 13. Coding Accounts

Accounts may be numbered, lettered, or symboled to facilitate their location upon the Ledger, and to save time and effort in indicating them on vouchers, journal entries, etc. Two schemes of numbering, in general, may be used in coding accounts:

1. Decimal system. Whole numbers indicate the principal classification, and decimals indicate subdivisions. The system is expandable indefinitely without requiring a change in numbers.

2. Universal system. The maximum number of accounts in each major group is determined, and a series of numbers are assigned each grouping;

Assets—Nos. 1–99
Liabilities—Nos. 100–199
Etc.

Numbers not needed at present are left blank for future expansion of the classification. Each business department may be indicated by a letter, and a given account, therefore, in the classification, regardless of the department, always has the same number:

Salaries account is numbered 213
Sales department letter is C
Therefore, Sales Department Salaries account is numbered C213

§ 14. Ledger Arrangement of Accounts

Accounts are arranged upon the Ledger in various ways. The guiding principle should be to so arrange them that statement preparation will be facilitated. The Trial Balance should hold the accounts in the order in which they are located in the Ledger and, also, in the order in which they appear upon the statements.

When the number of accounts is few, and one Ledger is large enough to contain them, the arrangement may be as follows:

1. Capital accounts
2. Asset accounts (not accounts receivable)
3. Liability accounts (not accounts payable)
4. Income accounts
5. Expense accounts
6. Accounts receivable
7. Accounts payable

When a business is large, the accounts receivable and payable may be held in subsidiary ledgers, each such detail ledger being represented upon the General Ledger by a controlling account. In such case, the Customers' Ledger Control would be located among the asset accounts in the position in which it would appear upon the Balance Sheet. The Creditors' Ledger Control would be found among the liability accounts in its position as displayed in the Balance Sheet.

As soon as the chart of accounts has been planned, and the forms of the two basic accounting statements prepared, it will be necessary to determine upon and secure the General Ledger. This phase of the subject will be discussed later. The names of the accounts will be entered in the index allowing a space or more between each account listed under the respective letters of the alphabet. When the indexing is completed, a page allotment can be made to each account so that the number of pages in the Ledger may be apportioned properly. The next step is to list the accounts consecutively upon the Ledger in the order in which they are shown in the chart which, as said before, should permit of ease in statement preparation.

§ 15. Illustrative General Classification

The following classification or chart of accounts is general in nature presenting the accounts which are used most frequently. The arrangement is that in which the accounts, as a rule, are found, the arrangement being in agreement with the classification of accounts as developed early in Course No. 1.

Asset Accounts

Current Assets
- Cash
- Petty Cash

- Notes Receivable
- Accounts Receivable
- Merchandise Inventory
- Investments (Current investments)
- Accrued Income
- Deferred Charges to Operation
  - Shipping Supplies
  - Insurance
  - Interest
  - Office Supplies
  - Other Deferred Charges

Fixed Assets

- Furniture and Fixtures
- Reserve for Depreciation of Furniture and Fixtures (deduction)
- Delivery Equipment
- Reserve for Depreciation of Delivery Equipment (deduction)
- Buildings
- Reserve for Depreciation of Buildings (deduction)
- Land
- Investments (Long time investments)
- Goodwill
- Other Fixed Assets

Liability Accounts

Current Liabilities

- Notes Payable (Short time notes)
- Accounts Payable
- Dividends Payable
- Accrued Expenses
- Deferred Income
  - Rent
  - Interest
  - Other Deferred Income

Fixed Liabilities

- Mortgages Payable
- Notes Payable (Long time notes)
- Bonds Payable
- Other Fixed Liabilities

Capital or Proprietorship Accounts

Vested Proprietorship
- Proprietors, Personal
- Proprietors, Capital
- Surplus (Undivided Profits)
- Reserves (Reserves from net profits)

Temporary Proprietorship—Operation Revenues and Expenses
- Sales
- Sales Returns and Allowances (deduction account)

Expenses
- Cost of Sales
  - Beginning Inventory
  - Purchases
  - Purchases Returns and Allowances (deduction account)
  - Infreight and Cartage
  - Ending Inventory (deduction account)
- Selling and Administrative Expenses
  - Selling Expenses
    - Salesmen's Salaries
    - Salesmen's Commissions
    - Salesmen's Traveling Expenses
    - Entertainment of Customers
    - Delivery Expenses
    - Outfreight and Cartage
    - Sales Management Salaries and Expenses
    - Depreciation on Sales Furniture and Fixtures, Equipment, etc.
    - Other Selling Expenses
  - Administrative Expenses
    - General Officers' Salaries
    - General Office Salaries
    - General Office Traveling Expenses
    - Stationery and Printing
    - Postage
    - Telephone and Telegraph
    - Legal Expenses
    - Sundry Office Supplies and Expenses
    - Depreciation on General Office Assets,—Building, Equipment, etc.

Heat, Light and Power
Taxes
Insurance

Temporary Proprietorship—Financing Revenues and Expenses

Revenues
Purchase Discount
Interest Income
Rental Income

Expenses
Bad Debts
Sales Discount
Collection Expenses
Interest Cost

Comment. The accounts marked "deduction accounts" are subtracted from the accounts below which they appear. For example, consider the assets; the deduction accounts do not represent assets. They measure reduction in asset values and must be carried because of the fact that the asset accounts to which they apply should at all times, on the Ledger, represent cost values. The deduction actually is carried out only on the Balance Sheet.

§ 16. Illustrative Chart of Accounts for General Ledger—Trading Concern

The following classification of accounts is a simple one, which is in actual use, and which differs somewhat from the one already presented. It is that of a trading concern.

1–100. *Balance Sheet Accounts*

1–25. Assets—Current

1. Cash. An account in which is recorded the cash in bank. It is debited by monthly summary entries for all cash received and deposited in bank, and it is credited by monthly summary entries for all cash paid out by means of checks.

2. Revolving Funds. Represents cash accounts of disbursing officers. They are debited for funds advanced and are credited for all amounts refunded or otherwise accounted for.
3. Petty Cash. Represents cash in hands of petty cashier. The account is debited for the fund advanced to the petty cashier for petty purposes, and is credited for all amounts refunded.
4. Accounts Receivable; Customers' Ledger Control. The account is debited monthly with the total amount of the items charged to individual customers' accounts, and it is credited monthly with the total of all cash and other settlements.

4a. Reserve for Uncollectible Accounts. The Expense account of Bad Debts is charged for monthly proportion, and this account is credited, with the amount estimated as sufficient to offset losses in realization of the accounts receivable. As actual losses are incurred, this reserve account is debited therefor.

5. Advances to Salesmen. Represents funds advanced to salesmen.
6. Employees' Accounts. Represents accounts with officers and employees.
7. Notes Receivable; Notes Receivable Register Control. The account is debited monthly with the face value of notes and other bills received, and it is credited monthly with the face value of notes and other bills paid.
8. Stock; Stock Ledger Control. The account is debited with the beginning inventory and from the Purchase Journal with the cost of merchandise purchased. Purchase returns and the cost price of all sales made are credited to it. Its balance, on any closing date, represents inventory of goods on hand.

9. Expense Distribution. Used only when the cashier or disbursing clerk cannot handle disbursement distribution. It is a suspense account and should have no balance at the end of the month.
10. Stock Suspense. A control account chargeable with all items of expense covering oncost of merchandise. A separate account is carried in a special ledger for each invoice. After all expenses are paid and charged to this account, the account is wiped out by crediting it and debiting Stock. The special ledger is columnar in form and loose leaf. One column is assigned to each article in the invoice which is to be spread over Stock. The total of each invoice is entered in a "total" column, and the items composing this total are then distributed over the other columns. The total and unit cost per commodity are secured by this means, and this particular sheet then serves as a permanent record for pricing. A percentage for leakage, breakage, shortage, or shrinkage may be charged hereto and credited to Shortage Reserve account. This account is valuable when the source of supply is distant, and there are various expense charges on incoming goods. Such charges properly should be added as part of the inventory cost of the goods. When the source of supply is near, such items as infreight, cartage, etc., may be charged to individual expense accounts, and each item thereby being treated as a regular expense charge; the suspension in such case is not necessary.

10a. Reserve for Stock Shortage.
See comment made above in 10.

11. Prepaid Insurance. This account is debited with all insurance premiums paid in

advance. It is credited monthly with a proportionate part, the expense account of Insurance being debited at the same time.

12. Prepaid Taxes. Handled in the same manner as the account of Prepaid Insurance.

26–50. Assets—Fixed

26. Land. This account is debited with the cost value of all land and permanent improvements thereto. It is credited with the cost value of land sold or otherwise disposed of.

27. Buildings. This account is debited with the cost value of all buildings and permanent improvements thereto. It is credited with the cost value of buildings sold or otherwise disposed of.

27a. Reserve for Depreciation of Buildings. The expense account of Depreciation is charged for monthly proportion, and this account is credited, of the amount estimated as sufficient to offset losses due to depreciation of buildings. The account is debited with all renewals and replacements of such assets as are made from time to time, and for actual losses as incurred.

28. Furniture and Fixtures. This account is debited with the cost of all furniture, fixtures, and miscellaneous store and office equipment. It is credited with the cost value of property sold, scrapped or otherwise disposed of.

28a. Reserve for Depreciation of Furniture and Fixtures. The expense account of Depreciation is charged for monthly proportion, and this account is credited, of amount estimated as sufficient to offset losses due to depreciation of furniture and fixtures. The account is debited with all renewals and replacements of such assets as are made from time to time, and actual losses incurred.

29. Investments. When an Investment account is considered as a fixed asset, it should record only long-time investments. Short-time investments which are made only to put into use an access amount of ready cash temporarily not needed should be booked as a current asset.
30. Goodwill. This account is debited with the cost of Goodwill; it is credited with the proceeds received from the sale of this asset or other realization thereof.

51–75. Liabilities—Current.

51. Accounts Payable; Creditors' Ledger Control. This account is credited monthly with the total amount of the items credited to the individual creditors' accounts. The account is debited monthly with all cash and other settlements.
52. Notes Payable; Notes Payable Register Control. The account is credited with the face value, monthly, of all notes and other bills given, and it is debited monthly with the face value of all notes and bills paid and received or otherwise settled.
53. Notes Receivable Discounted. Used to record the contingent liability set up when a promissory note is discounted. When a note is discounted, this account is credited. When the maker redeems the discounted note or paper, the Notes Receivable account is credited and this account is debited.
54. Accrued Interest. Credited monthly with interest accrued, at same time debiting the expense account of Interest. It is charged from Cash with the interest paid. Balance represents amount accrued but unpaid.

76–90. Liabilities—Fixed.

76. Mortgages Payable.

91–100. Proprietorship.

91. H. Jones. Personal Account. This account is debited with all withdrawals during each accounting period and with H. Jones' share of all losses. It is credited with his share of the profits. The books, when closed, require that the balance be carried to the account of H. Jones, Capital.
92. G. Burton, Personal Account. See comment for account No. 91.
93. H. Jones, Capital Account. This account is credited with the capital contributions of H. Jones. The balance of his personal account should be transferred here after adjustment when the books are closed.
94. G. Burton, Capital Account. See comment for account No. 93.
95. Profit and Loss. A temporary account made use of when the books are closed, into which are transferred the debit and credit balances of all revenue and expenses accounts, plus the cost of goods sold. The balance is transferred to the partners' personal accounts.

101–200. *Profit and Loss Accounts*

101–110. Revenue.

101. Sales. This account is credited at the end of each month from the Sales Register with charge sales for the month.
102. Cash Sales. This account is credited at the end of each month from the Sales Register with the cash sales for the month. The credits from the Sales Register should equal the cash debits therefor from the Cash Book.
103. Returned Sales. This account is debited monthly with the returned sales from the Returned Sales Register.

106. Exchange Earnings 107. Purchase Discount 108. Interest Earnings	These accounts record non-operating revenue. They are credited respectively with the items their titles suggest.

111–200. Expenses.	Operating 111–125. Selling 126–175. Administrative Non-Operating 176–200. Financial

111. Salesmen's Salaries. This account is debited with salesmen salaries paid or accrued.
112. Salesmen's Expenses. This account is debited with salesmen's expenses incurred.
113. Entertainment. This account is debited with the cost of entertainment.
114. Advertising. This account is debited with advertising and publicity costs.
115. Delivery Expense. This account is debited with all delivery costs.
125. Miscellaneous Selling Expense. This account is debited with incidental items of selling expense not otherwise provided for in accounts above.
126. Office Salaries. This account is debited with office salaries paid or accrued.
127. Printing and Stationery. This account is debited with the cost of printing and stationery (not advertising), as letterheads, envelopes, carbon paper, etc.
128. Telegrams, Telephone, and Postage. This account is debited with all costs of telegrams, telephone, and postage.
129. Legal Expense. This account is debited with all costs of legal service.
130. Depreciation. See comment covering Reserve for Depreciation account.
131. Rent. This account is debited with rent due or accrued.

132. Fuel and Light. This account is debited with the cost of fuel and light.
133. Taxes. This account is debited monthly at the same time that account No. 12 is credited.
134. Insurance. This account is debited monthly at the same time that account No. 11 is credited.
135. Repairs. This account is debited with repair charges paid or accrued.
175. Miscellaneous Office Supplies and Expense. This account is debited with incidental items of administrative supplies and expense not otherwise provided for above.

176. Bad Debts 177. Sales Discount 178. Exchange Lost 179. Collection Expenses 180. Interest Lost	These accounts record non-operating expense. They are debited respectively with the items their titles suggest.

§ 17. Care to be Observed in Designing a Classification of Accounts

In designing a classification of accounts, the constructor must keep in mind at all times the Balance Sheet and the Statement of Profits and Income which he is desirous of preparing. Since all accounts lead up to these statements, the accounts used must provide the summaries required for their proper preparation. The previous study of statement preparation, as covered in Course No. 1, will show that the accounts in the above classification are arranged substantially in the order in which they will appear in the two basic statements just referred to.

Attention should be directed to the manner in which the above accounts are numbered. Similar group items are given a consecutive series of numbers; for example, current assets have reserved to themselves the numbers 1–25.

After a chart of accounts has been prepared, the forms of the statements should be designed so that if a change is necessary in the chart the alteration may be made before the accounting records are purchased or arrangements made for having them printed.

In writing out an explanation covering the use of each account in the classification, the types of transactions to be recorded must be kept foremost in mind. Each transaction affects a certain group or groups of accounts. When these are known, it is not difficult to indicate which particular account within the group is affected. In determining main groupings, care must be observed to avoid reaching a wrong conclusion, because by so doing the Balance Sheet and the Statement of Profits and Income will show incorrect results when the time comes for their preparation. The fundamental distinction between capital and revenue expenditures must be kept in mind.

§ 18. Capital Versus Revenue

In accounting, the term "capital" may have a number of meanings, although basically the idea is the same in all cases. The excess of assets over liabilities is "capital." It represents, so to speak, the amount by which a business is indebted to its proprietor or proprietors for the investment unimpaired plus accumulated profits. "Deficit," on the other hand, represents the excess of liabilities over assets, and represents, as it were, the indebtedness of the proprietor or proprietors to the business for losses beyond the amount of capital originally invested.

"Revenue" is that which an enterprise earns. It is the excess of income over expenses. There is no revenue if the expenses exceed the income. And when expenses do exceed income, capital is decreased:

1. By a reduction of the accumulated surplus, or
2. By the impairment of the original investment.

"Capital receipts" is a term which, in general, refers to any capital investment. It is applied to the proceeds received from the sale of fixed assets, as distinguished from the proceeds received from the sale of goods which a concern has for sale in the regular course of business. "Revenue receipts" refers to income received in either of one of two ways:

1. As earnings on invested capital, or
2. As proceeds from the trading activities of a business in so far as they constitute business profits.

"Expenditure" is a term referring to the disbursement of cash, or to the giving of any other property,—or to the creation of a liability, for property of some other kind, or for services received. "Capital expenditure" is a term which refers to the exchange of one asset for another,—capital is neither increased nor decreased thereby,—an asset value is given and an equivalent asset value is received in exchange. In brief, a capital expenditure represents all sums expended for addition to, or improvement of, properties; all such sums should be charged to the asset accounts affected.

"Revenue expenditure" is a term referring to all expenditures which are proper charges against income, such as salaries, wages, rent, advertising, repairs, etc.; they are "expenditures made in connection with the running expenses of the legitimate business of the firm or corporation concerned." "If an expenditure has only had the effect of placing the earning power of the undertaking upon the same footing as that which had previously obtained, it must be charged to revenue."

CHAPTER III

THE LEDGER

Part 1. Ledger Construction

§ 19. Constructive Development of the Ledger Account

The unit of construction for the Ledger is the column, a certain amount of paper space enclosed within two vertical lines. The simple form of Ledger account contains two columns, one in which amounts showing increases in the account total are arranged in vertical order to make the addition of the separate items easy, and one in which amounts showing decreases are set up in vertical order likewise for purposes of addition. Subtractions should never be made on the face of an account except by showing the amount of the decrease in the column opposed to the one in which increasing amounts are displayed.

In relation to the account, the function of the Journal is to classify the debits and credits of each business transaction. In the Journal, such debits and credits are not collected in like groups,—account groupings. But since these groupings are absolutely necessary to the proper disclosure of financial condition and progress, these debits and credits are collected in the Ledger from the Journal according to account classifications, the better to be of use in interpreting business activity.

The Ledger is an accounting record in which the transactions entered upon the books of original entry are classified by accounts as prescribed in the chart of accounts. Each account therein groups the debits and credits relating to such account; on the one hand, as to increases and, on the other, as to decreases. The Ledger, there-

fore, is related closely to the account since it constitutes a collection of them, in such form that the totals therefrom may be set out in the statements indicating financial condition and progress.

The constructive development of the Ledger is based upon the arrangement of the columns thereon and upon its subdivision. The arrangement of the columns is made use of to facilitate comparison between the posted debit and credit items, and to secure the proper expression of the information regarding each debit and credit entry,—consideration being given to convenience in posting and to ready reference. The subdivision of the Ledger is made use of to secure a localization of errors the better to expedite the securement of a Trial Balance,—the latter being a test made use of to prove the equality of the total of the debits and of the credits as recorded. Likewise, its subdivision enables the bookkeeping work to be divided among a number of employees; to this end the controlling account expedient with the corresponding columnar development of the records of original entry plays an all important part. By means of the controlling account, one Ledger is replaced by two or more Ledgers,—a General Ledger in which the controlling account or accounts take the place of a certain group or groups of detail accounts without interfering with the ledger principle of equilibrium; and one or more subsidiary ledgers, one for each separate group of similar detail accounts.

Later, in the study of purchase records, it will be noticed that the use of the Voucher Record, also, relieves the Ledger of a certain amount of detail connected with purchase transactions.

§ 20. The General Ledger

The General Ledger is the principal bookkeeping record. All records of original entry are merely pipe lines

through which flows the recorded information concerning business transactions. In Course No. 1, it was stated that the Ledger is either in bound book form or in loose leaf form. It is the accounts collected together as a group, and bound up in the form of a book, or the collection of the accounts, each on a separate card or sheet, the whole taken as a unit, which compose and make a General Ledger.

But based upon the remarks made in the last section above concerning ledger subdivision, the General Ledger in a modern system more and more assumes the character of a summary record, a record of controlling accounts,—the accounts therein being of a summary nature the better to secure periodic proofs and controls. This fact was brought out in Course No. 1, in connection with the discussion on controlling accounts. No matter how many Ledgers are kept, they all may be considered as sections of one Ledger, the General Ledger, in which each section is represented by a summary account—its controlling account.

The controlling account, by helping in the localization of errors when ledger records are many, enables each separate section of the General Ledger to be proved up as having been accurately manipulated. In this connection, each ledger section—or subsidiary Ledger, is tested for accuracy by being required at all times to be in agreement with the balance of the controlling account for that section—or subsidiary Ledger, as found in the General Ledger. By use of the controlling account expedient, statements may be prepared before each detail Ledger has been posted up completely; the organization procedure leaning toward the division of the posting work among a number of employees, and the localization of errors to a specific group of accounts permits this.

§ 21. Standard Ledger Ruling

The standard ledger ruling is well known—being the most common form in use. It is unnecessary to illustrate the ruling here. In general, the standard ledger form is preferable to any other. As a rule, the standard form meets all the requirements found under ordinary conditions encountered. The ruling should be used when the distinction between the debit and credit items is more important and desirable than a distinction from some other viewpoint.

Since records of original entry now are being developed to a highly analytical degree, and the controlling account is used so often that the General Ledger is practically under constant and perfect control, the bookkeeping labor required in connection with the General Ledger amounts to but little. Most of the entries going into it are monthly postings in total amounts, made possible by the use of various analytical Journals. As a result, there is not much of a current problem as concerns General Ledger development leaning toward the reduction of bookkeeping labor. The negligible importance of this problem results in the fact that the standard Ledger ruling is the one most frequently found in the General Ledger.

§ 22. Variations from Standard Ruling

The conditions mentioned in the last paragraph do not apply to the detail subsidiary Ledgers, as the Customers' Ledger, etc. In connection with these, the bookkeeping work may be voluminous, especially if the organization is at all large; in one wholesale house, for example, eight men do nothing else but keep the many customers' Ledgers that are used. When such a condition is encountered, a serious management problem is met with. How may labor costs be reduced without curtailing in any

way the volume of detail Ledger work now regularly accomplished? The question may be, also: How may the amount of detail work required on the subsidiary Ledgers be reduced without increasing labor costs, at the same time permitting a larger volume of business to be cared for than at present?

From one point of view, the answer to the above questions involves the rearrangement of the standard Ledger ruling, and from another point of view it involves the use of bookkeeping machines. The question of departing from the standard Ledger ruling is first to be considered. The standard Ledger ruling may be deviated from when:

1. The distinction between debits and credits is not as important as some other consideration.
2. The distinction between debits and credits is important and desirable but, in addition, some other consideration must be borne in mind.

Methods of deviating from the standard form of Ledger account are based upon the following main principles:

1. Shifting the position of the debit and credit columns. This results in one of the followlowing forms:
    - a) Debit and credit columns placed together in the center of the account
    - b) Debit and credit columns placed together at the right of the account
    - c) Debit explanation column is of a different width from the credit explanation column
2. Adding one or more money columns:
    - a) To hold a balance
        - i. One balance column
            1. Balance column placed in center between debit and credit columns

2. Balance column placed at right of form
- ii. Two balance columns
3. Debit and credit balance column placed in center between debit and credit columns
4. Debit and credit balance column placed at right of form
- b) To be subsidiary to the basic columns
  - i. Memo column subsidiary thereto
  - ii. To hold analysis of a basic column amount
    1. Columnar Ledger
- c) To hold money amounts in progression from left to right across the page rather than from top to bottom of the page
  1. Tabular Ledger
- d) To secure a combination of some of the above shown in a, b, and c.

§ 23. Ledger with Debit and Credit Columns in Center

Money columns on a Journal often are separated one from the other so that the chance for error due to posting items of one class as items of the other is reduced to a minimum. In a Ledger, on the other hand, the reverse of this principle may be more satisfactory to facilitate securing the balance of the account. This would be true where the balance of an account is needed frequently, although not after every transaction. The following Ledger heading illustrates the principle:

Date	Item	L. F.	Debits	Credits	L. F.	Item	Date

§ 24. Ledger with Debit and Credit Columns at the Right

When the debit and credit columns are placed together at the right of the account, the account resembles a simple

Journal in appearance. In fact, such a ruling is called a "Journal ruling." This form would be desirable when the number of debit entries or the number of credit entries is considerably larger than the number of credit entries or the number of debit entries respectively. In other words, such a form is useful as a space conserver when most of the entries are either debits or credits. Customers' accounts usually contain more debits than credits. And where such is the case, paper space is conserved by the use of a Journal-ruled Ledger; two or three of these forms may be set out on a page from left to right, whereas, if a standard ruling were used, one form would fill the width of the page. The following Ledger heading illustrates the principle:

Date	Explanation	L. F.	√	Debits	√	Credits

§ 25. Ledger with Wide Explanation Columns

The debit entries in an account may require fuller and more complete explanation than the credit entries, or vice versa. Under such conditions, a wide explanation column may be desirable on the debit side and a narrow explanation column on the credit side, or vice versa. Such a condition occurs in certain branch offices. Here the branch office Ledger concerned with home office invoices may require full ledger explanations to facilitate statement preparation. The following Ledger heading illustrates the principle:

Date	Explanation	L. F.	Debits	Date	Explanation	L. F.	Credits

§ 26. Ledger with Balance Column in Center

When the balance of an account is to be abstracted frequently, a Ledger with a balance column in the center, between the debit and credit money columns, will prove useful. However, such a Ledger form will not answer satisfactorily when the balance is to be taken after each

transaction, or when the balance is to be indicated upon each individual Ledger account at the time of drawing a Trial Balance. In using a form ruled in this manner, the first entry for each month, debit or credit, should be entered one line below the balance figure. By so doing, the transactions of any single month will be grouped between the opening and closing balances for that month. This form is popular in an accounts receivable or accounts payable Ledger. Notice that this ruling is similar to the one shown above "Ledger with debit and credit columns in the center" except for the inclusion of the balance column. The following heading illustrates the principle:

Date	Explanation	√	Debits	Balance	Credits	√	Explanation	Date

§ 27. Ledger with Balance Column at Right

When a balance is desired only at the time a Trial Balance is prepared, the balance column should be located at the extreme right of the Ledger form rather than in the center. By so placing the balance column, it will be out of the way during the period until the time has arrived for its use. However, this form can be adopted with almost equal advantage to the previous form containing the balance column in the center, except that the greater possibility of making debit entries in the credit column and credit entries in the debit column demands that more care be employed in connection therewith to reduce the possibility of error to a minimum. The following Ledger heading illustrates placing a balance column at the right and the debit and credit columns together:

Date	Explanation	L. F.	Debits	Credits	Balance

A balance column in this position may prove most advantageous in connection, also, with a Journal-ruled

Ledger. Such a form is excellent for a customers' Ledger when the debits greatly exceed the credits in number and when it is desired to set out the balances for convenient reference. Likewise, a Ledger ruled in this manner proves desirable at times as a corporation Stock Ledger, because thereon the total number of shares of stock held by each stockholder may be seen at all times, as required by law.

One form of accounts receivable Ledger embodying the principles above shown is indicated below since it is in common use in many retail establishments of moderate size. The form is in duplicate. The original is as indicated; the duplicate is a plain sheet of a color different from the original. The original is perforated near the left binding margin. When a bill is paid, the original sheet is detached along the perforations and is given the customer. The duplicate is retained. Periodically, the bookkeeper removes all duplicate sheets of paid accounts filing them away in alphabetical order. These duplicate sheets are valuable for keeping a check on moneys received on account by the cashier. The following Ledger heading illustrates the idea:

Sold by	Date	Items	Charges	Credits	Balance

§ 28. Ledger with Two Balance Columns

In certain enterprises, all transactions must be shown upon the Ledger as soon as they occur,—postings to be made every day though the Ledger is out of balance. Under such conditions, it is difficult to prove the work. However, a standard Ledger form with a balance column on both the debit and credit sides will prove helpful. In such cases, the total of the debits and credits up to date or for the month to date is placed in these columns. New entries may be inserted without disturbing the work of a previous period.

The double balance column Ledger account is useful, also, where either a debit or credit balance may appear in the account. Many Ledger accounts can have no other than one kind of balance; in such case, the form with a single balance column answers the purpose. The following Ledger heading illustrates one form of Ledger account with a double balance column:

Date	Explanation	L. F.	v	Debits	v	Credits	Balance Debit	Balance Credit

§ 29. Ledger with Memo Column Subsidiary to the Two Basic Columns

This form of Ledger proves useful under the following conditions:

1. To show amounts in two currencies
2. To show interest upon account balances
3. To show exact condition of a customer's account when his credit limit is fixed where he has dealings both on open account and in respect of notes receivable.

Such a Ledger ruling contains two debit and two credit columns. The outside columns would be used in the ordinary manner. The inside columns are of memorandum character only. The Trial Balance figures are secured from the regular columns only, except as in the case of (2) above under which the net interest balance at trial balance time must be taken over into the regular columns.

§ 30. Columnar Ledger: Ledger Analysis Sheets

When the detail items which compose the total of a summary amount are many, it may not be advisable, on account of the tendency to make the General Ledger unduly bulky, to assign a separate account page to each such sub-classification. In fact, it might develop that the vol-

ume could not hold all of them with its covers. In such case, the columnar ledger principle will prove useful. This may be adopted as follows:

> 1. The Ledger page may be widened so that on one page there may be included the summary amount in a "total" column, and the supporting details shown annexed thereto in distributive columns.
>
> 2. If the sub-classifications covering a summary account are exceedingly numerous, a wide Ledger page may not be large enough to include all the necessary distributive columns. In such event, a standard ruled form of ledger page may be used to hold the summary account, this being supported by a separate analysis sheet kept in another binder, titled "General Ledger Analysis."

The two above conditions are illustrated as follows:

I

DELIVERY EXPENSE

Date	Explanation	L. F.	v	Total Dr	Wages	Stable Expense	Delivery Repairs
				2			

DELIVERY EXPENSE

Date	Items	L. F.	Dr	Date	Items	L. F.	Cr

DELIVERY EXPENSE ANALYSIS
MONTH OF......................

Total	Payroll	Feed & Bedding	Stable Expense	Horse Expense	Harness Repairs	Wagon Repairs	Auto Repairs	Sleigh Repairs	Etc.

For further illustration of a columnar Ledger, refer back to the last chapter on the discussion of the account "Stock Suspense" in the section on "Illustrative Chart of Accounts for a Trading Concern."

In like manner, a division might be established in the General Ledger Analysis book for Administrative Expense, for Office Supplies, for Advertising, Equipment Installation, Equipment Repairs, Building Repairs, etc.

In fact, this distribution principle could be carried to the point of securing a very minute analysis and yet have the Ledger accounts representing the total of each classified analysis but few in number. If the proprietor should care to inspect the General Ledger as kept in this manner, he will be able to see quickly the total expense of any grouping in which he may be interested. By inquiry, also, he could determine at once the detail expense of the period which supports the total shown in reference to the particular grouping in which he is interested.

If, for example, the credit items are infrequent, it may be sufficient to columnarize only the debit side of the account in question, as above shown. Detail items on the credit side may be indicated in red ink; if in black ink, not advisable, a subtraction should be made at once. Here we have a possible exception to the rule formerly stated that subtractions should not be shown upon the face of a Ledger except by entry upon the opposite side.

The columnar Ledger is coming more and more into use, not only in connection with nominal accounts,—the basis of the explanation above used but, also, in relation to the real accounts. Frequently, for example, a ledger account with Land will be developed to show total land value in a total column, and the value of each parcel in a set of accompanying distributive columns. Remember, as a rule, that if the account classifications are few, separate ledger accounts, ordinarily, should be used for each detail sub-classification; that the columnar ruling principle should be adopted only when the classifications are numerous, and that in this connection it is usually advisable to adopt the analysis sheet method rather than to carry the distribution upon the Ledger proper.

In the subsequent chapter on Purchase Records a similar loose leaf book has been suggested titled "Purchase Analysis Record." This record supports the principal

purchase accounts in the General Ledger, making the latter more complete and thus more useful.

§ 31. Tabular Ledgers

The tabular Ledger is an outgrowth of the Journal form of Ledger. It is familiarly known as the "Boston" Ledger, its form originally having been developed by a bookkeeper in a Boston bank. Entries of amounts are made by periods from left to right across the page instead of from top to bottom. Each line is given over to one account; therefore, the downward progress on each page concerns only the names of individual accounts. Formerly, this form of Ledger was very popular; but with the incoming of bookkeeping machines it is being displaced rapidly, especially in the larger organizations.

The tabular Ledger may be considered useful only when all accounts, in general, receive the same entries at definite periodical dates, as daily, monthly, or quarterly. Therefore, such a Ledger may be useful under the following conditions:

1. Tenants' Rental Ledger.
2. Members' Ledger—club or lodge
3. Bank depositors' Ledger
4. Gas, light, and water company customers' Ledger
5. Instalment business customers' Ledger
6. Storage warehouse customers' Ledger
7. Etc.

§ 32. Tabular Ledger in a Real Estate Office

In a real estate office which collects rents from tenants, the rents are collected, usually, once a month. The period of time is fixed; the debits and credits must be recorded periodically; the number of debits and credits to each account are few; the work is to be proved by totals.

All these reasons point to the successful use of a tabular Ledger.

A real estate office acts as a broker or agent or both. In acting as a broker, property is bought and sold on commission. In acting as an agent, the business concerns the management of rented property. If each landlord has only one piece of property with one tenant in possession, the activities of the office may well be taken care of by the use of the "Single Entry" system. If the landlords have several properties or several tenants, a Double Entry system should be installed. The accounts required in connection with tenants under the second possibility are:

1. Accounts with the landlords
2. Accounts with the properties
3. Accounts with the tenants

The tenants' Ledger is decidedly useful hereunder. The Ledger would contain a two-way division:

1. A division for each separate property; part of a page or several pages are given over to each property depending upon the number of tenants.
2. Within each division, one line would be given to each tenant.

The perpendicular rulings on each page provide first for assembling the following information concerning each tenant:

1. Number of house, flat, or office
2. Name of tenant
3. Commencement of lease
4. Term of lease
5. Monthly rental

This information would be followed at the right by a set of columns, one set for each month, beginning with the month on which the annual moving day falls, say, the month of April:

1. April
    a) Balance
    b) Monthly rental charge
    c) Monthly credits
        1. Date
        2. Amount of payment
2. May
    a) Balance
    b) Monthly rental charge
    c) Monthly credits
        1. Date
        2. Amount of payment
3. June (Repeat as before)
4. Etc.

A record so arranged will permit the securement monthly, by addition, the following facts:

1. Total monthly charges against tenants
2. Total monthly payments by tenants
3. Total monthly balances due from tenants

The bookkeeping procedure in connection with this record works about as follows:

1. Bills are made out monthly in duplicate
    a) Original bill sent tenant
    b) Duplicate retained as basis of entry in tenants' Ledger

2. Cash collected entered on Cash Book in special column of Receipts Record. Adjustments made, perhaps, through Journal

3. Each payment credited to tenant on Tenants' Ledger

4. Unpaid balance extended monthly into "balance" column

The first periodical summary entry is made from the total monthly charges against tenants:

Dr. Tenants (controlling account)
    Cr. Rents Receivable

The second periodical entry concerning payments is not made, however, from the Tenants' Register, as might first be thought. Since certain adjustments are possible, it is the practice, and correctly, to secure the second summary entry from the Cash Book and other records. This in effect would be as follows:

a) Dr. Cash (from Cash Book)
   Cr. Tenants (in detail on register)
      Tenants (controlling account)
b) Dr. Rents Receivable
   Cr. Owners or Landlords (controlling account)
      Individual Owners or Landlords (in detail on subsidiary Ledger)

These entries would account for the cash received. The special adjustments would be handled in a similar manner. Eventually, therefore, after the above entries have been completed, the total monthly balances due from tenants, as per the Tenants' Ledger, representing unpaid accounts receivable, (a debit in agreement with Tenants' Control on General Ledger) should offset exactly the credit balance in the Rents Receivable account. When the owners or landlords are paid, the entry would be:

Dr. Owners or Landlords (controlling account)
   Individual Owners or Landlords (in subsidiary Ledger.
Cr. Cash
   Collection Fees | Cash Book

From the above explanation, it should be noticed that the manipulation of a Tenant's Ledger indicates it is used both as a record of original entry and as a Ledger, a fact not to be forgotten. A form of heading for a Tenant's Ledger is shown below:

Tenants Ledger

Year..............					April				Etc.
	Tenant						Credit		
Space	Name	Lease Date	Term	Rental	Balance	Charge	Date	Amount	Balance
Total									

§ 33. Members' Ledger—Club or Lodge

The same reasons as set out near the beginning of the last section apply to the use of a Ledger in which to record the accounts of members of a club or of a lodge. Membership dues often are collected quarterly. If collected yearly, the correct use of a tabular Ledger is doubtful, a three column Ledger perhaps being preferable, showing charges, credits, balance.

§ 34. Bank Depositors' Ledger

In a bank, depositors' accounts (active) are balanced daily, so that at all times the condition of each account may be known. The Boston Ledger has been popular in bank accounting, but now the use of bookkeeping machines is forcing it out. For inactive accounts, however, it is questionable whether the tabular Ledger should be favored; it would be better in this case, perhaps, to use a simple three column Ledger showing debits, credits, balance. The headings for a tabular Ledger for depositors' accounts are indicated below:

Year
Name
Balance
  Dr.
  Cr.
Monday
  Checks
    Items
    Total

Deposits
Balance
Dr.
Cr.
Tuesday
Etc.

§ 35. Gas, Light, and Water Company Customers' Ledger (Rate Register)

The tabular Ledger has been a favorite in utility companies for use with customers' accounts. Here, too, its continuation is being curtailed due to the advent of machine methods.

§ 36. Installment Business Customers' Ledger

Regardless of the nature of an installment business, installment sales and collections are readily handled by means of a tabular Ledger. Consider the following proposition:

> Problem. The Glen Ridge Land Company sells lots by installment contract. The requirement is that the first payment upon each contract must be 25 per cent. of the purchase price. The balance is to be paid in twenty-five equaly monthly installments. Construct a form of tabular Ledger which may be used to advantage by this company.

Solution.

Name
Address
Contract
Number
Date
Amount
Month of................
Balance
Charge
Credits

Date
L. F.
Amount
Month of...............
Balance
Etc. as before
Repeat

Twenty-five per cent. of the sales price should be entered in the "balance" column under the month in which the sale was made. Each month following, a charge equal to one twenty-fifth of the unpaid balance of seventy-five per cent. of the contract price should be charged against the purchaser. On the first day of each month, the unpaid balance of any customer will be shown in the "balance" column. The amount of this balance plus the current charges less the current credits represents what each purchaser owes the company. Since provision must be made for twenty-five installment payments subsequent to the initial down payment, a twenty-five months' record from left to right must be provided for. However, since it is advisable to show each year's operations separately, only a twelve months' record from left to right is absolutely necessary. At the beginning of each year, the balances outstanding would be brought forward.

If the record becomes of undue width from left to right when making provision for the requirements of the business, it would be advisable to introduce what is known as the "long and short page" expedient. The width of any one page should not provide for more than fifty columns if accuracy of entry is to be secured. This expedient in the above case might work out as indicated below. When the record is opened, the wide right-hand sheet may accommodate seven months' entries, and the wide left-hand sheet, the basic information plus entries for one month. Eight months' entries have thus far been

taken care of, four yet remaining. A short sheet would then be ruled to provide for two months' entries on each side and would be inserted between the left and right wide sheets. The result then would be, when the book is opened, reading from left to right:

- Left-hand wide page:
  - Name
  - Address
  - Contract
    - Number
    - Date
    - Amount
  - Month of January
    - Balance
    - Charge
    - Credits
      - Date
      - L. F.
      - Amount
- Right-hand short page
  - Month of February
  - Month of March
- Left-hand short page
  - Month of April
  - Month of May
- Right-hand wide page
  - Month of June
  - Month of July
  - Month of August
  - Month of September
  - Month of October
  - Month of November
  - Month of December

§ 37. Machine Bookkeeping

Mechanical devices designed to reduce bookkeeping costs are many; all of them are for use with subsidiary Ledgers, and none of them are for use with the General Ledger. The aim and purpose of these machines is to

supplant posting to the Ledgers by hand, a process which at best is slow and inaccurate and, therefore, inefficient. Basically, all of these machines are about the same, consisting of a combination typewriter and adding machine. The detail Ledgers, when used with such a machine, are loose-leaf or card Ledgers. When the posting process is to commence, the Ledger, if loose-leaf, may be placed upon a sort of framework, especially designed, and the back of the Ledger unlocked so that the leaves are loosened.

A page is taken out, placed in the machine, certain keys on the machine are pressed downward, and the desired posting is printed on the sheet. The sheet is then taken out and placed again in the Ledger binder. The form of Ledger sheet used with bookkeeping machines is one specially designed, and so ruled that a running balance of each account may be secured by the use of an adding device attached to the machine. The device permits of either adding or subtracting and, therefore, either debits or credits may be posted.

Ledger postings and writing up each customer's monthly statement are done together at the same time, by using two sheets separated by a carbon. The customer's statement is on top and the carbon copy is made on the Ledger sheet.

§ 38. Loose Leaf Versus Bound Ledgers

Two types of books may be used for the record of final entry:

1. Loose leaf
2. Bound

Some of the advantages of the loose leaf Ledger are:

1. It is flexible
2. It may be readily indexed

3. Its sheets may be renewed without rewriting the whole book
4. It never requires more sheets within its covers than there are accounts in use

Some of the disadvantages of the loose leaf Ledger are:

1. Falsification of the records may be assisted; sheets can be removed and others inserted without the knowledge of the management. Therefore, there is no guarantee that all the accounts are in the book
2. The size of the sheet required in a loose leaf Ledger usually is larger than that needed in a bound Ledger because a wide binding margin must be provided for in order that the book, when opened, will lie flat presenting a flat writing surface
3. It is more expensive than a bound Ledger of similar quality

Therefore, what type of Ledger shall be used? Circumstances alter cases. Two questions arise:

1. Do the advantages of the loose leaf Ledger exceed the disadvantages?
2. Is it possible to eliminate certain or all of the disadvantages?

The first disadvantage may be done away with. A record can be kept of every sheet introduced into a loose leaf book and an approval mark required on every sheet to be placed therein, said mark to be made by some one in authority. If the sheets are numbered an accounting for each may be demanded. Means of protection in this regard are many; this, coupled with improvements which are constantly being made in accounting methods, reduces the number of disadvantages to such a point that now it is more or less the principle of convenience and adaptability that governs any particular case.

Many experienced accountants recommend the bound book for a General Ledger and for a Private Ledger (lat-

ter to be discussed later) suggesting loose leaf books for the subsidiary Ledgers. In general, this seems to be a pretty good rule to follow. In selecting a Ledger to be used a number of years, consideration should be given to the size of the book, the quality of the paper, and to have a book which opens flat upon the desk. Likewise, under all conditions care should be given to the character of the information to be carried within its covers and to the method of arranging and presenting the information thereon before a Ledger is selected. Loose leaf records are discussed further in the next chapter.

§ 39. Stock Loose Leaf Ledgers

Certain loose leaf Ledger rulings which are considered standard are carried in stock by almost every stationery store and office outfitter of consequence. In many instances these rulings can be employed with satisfactory results, their adoption often saving time and expense. Sometimes a stock form is not satisfactory for the reason that the printed headings are not as required; it is possible, frequently, to secure the stock ruled sheets and have printed headings inserted as desired.

Standard-ruled Ledger sheets can be secured in almost any size that might be desired, being ruled in various colors and prepared with or without printed headings. A very satisfactory size for adoption in a large number of offices will be 9¼ inches binding margin by 11⅞ inches in width. This sheet affords ample space for date, explanation, folio, and debit and credit amounts. The three column form with balance column in the center is a popular stock sheet for an account receivable Ledger or an account payable Ledger. Likewise, the three column ruling with balance column at the right usually is carried in stock. Ledger sheets with four accounts to the page have been prepared by many stationers so that a

bookkeeper can employ one or more sheets for sundry accounts in connection with each letter of the alphabet. The adoption of a sheet of this kind is preferable to the practice followed in some offices of posting infrequent accounts to a "sundry" section of the Ledger in which only one line is given to each account.

§ 40. Card Ledgers

The adoption of a card Ledger in connection with accounts receivable and accounts payable will assist the accounting department when there are so many accounts that bound books or loose leaf Ledgers become cumbersome. It is sometimes difficult to arrange accounts in a bound Ledger in such a manner that the arrangement will at all times be advantageous. Likewise, loose leaf Ledgers, with the introduction of a large number of sheets, become bulky and difficult to index. The use of the card Ledger may eliminate these undesirable features. However, they should not be employed in connection with the General Ledger. For safe keeping, drawers holding the cards should be built into the office safe.

PART 2. THE PRIVATE LEDGER

§ 41. Ledger Control

Control over a Ledger is secured, usually, by agreeing the Ledger totals with those from the original records, each total being secured independently. Postings to a Customers Ledger, for example, may be made from the records of original entry. If, in making the original entry, an error creeps into the work, as a wrong computation, such error will not come to light by an examination of the Customers Ledger Controlling Account. But if an error were made in posting an item from the original

record to a customer's account upon the Accounts Receivable Ledger, the fact that an error had been made would be disclosed by a comparison of the controlling account total with the total of the abstract drawn from the Customers Ledger.

Since the person who keeps the controlling account over a detail Ledger should not, where possible, keep the detail accounts which are controlled, care must be exercised to see that the figures used by each are the same. This may be done by routing the original paper so that the controlling account keeper first utilizes it, and when he is through the detail accounts keeper next makes use of it. Or, the original document may be made out in duplicate, one copy going to the controlling account keeper and the other to the keeper of the detail accounts.

§ 42. Private Ledger Defined

A Private Ledger may be considered as a section of the General Ledger kept in a separate cover which contains accounts of a confidential nature only. Often, such a Ledger is made with a lock so that no one can open it unless he has the key.

In every business of any size there is considerable information which the management desires to keep to itself, especially with regard to such items as capitalization, inventories, investments, long time indebtedness, owners, fixed assets, etc.,—the accounts which give information concerning the financial position and the profit or loss. In a large office, the asistant bookkeepers, as a rule, are transient characters, not remaining in one place any great length of time. The use of a Private Ledger will keep them from discovering vital facts concerning the financial position of the organization and its profit progress which would be, at times, of great use to outsiders. Also, no matter how much confidence is placed in the head book-

keeper, it may not be desirable to "let him in" on important and confidential matters.

The number of entries affecting accounts of a private nature are few in number and may be kept easily in a separate record by the manager, his secretary, or the company's head accountant.

The discussion herein on the Private Ledger does not at all present the only way in which the private books may be kept. Their keeping varies a great deal; the underlying principles, however, are as described. If the student understands thoroughly the principle underlying the use of the Customers Ledger Controlling Account, by means of which the General Ledger articulates with the Customers Ledger, he should find no difficulty in comprehending the handling of a Private Ledger.

§ 43. Controlling the Private Ledger

The Private Ledger should be controlled by the General Ledger, the latter containing a controlling account which in its nature is similar to the controlling accounts kept for the usual subsidiary Ledgers.

The General Ledger, in a system operating a Private Ledger correctly, would contain only the current asset accounts of Cash and Accounts Receivable, and the current liability accounts of Accounts Payable,—those which are built up from day to day in the regular course of business, and a controlling account with the Private Ledger to represent all the others. The General Ledger, containing accounts with such items as Cash, Accounts Receivable, and Accounts Payable, is brought into balance by the Private Ledger Controlling Account which will have a balance, a credit or debit, equal in amount to the balance in the General Ledger Controlling Account found on the Private Ledger, debit or credit.

The accounts receivable may be recorded upon the

General Ledger in a controlling account. If so, the General Ledger balance in the Accounts Receivable Controlling Account controls the detail accounts in the Customers Ledger, and the General Ledger, in turn, when a Private Ledger is used, is controlled by the General Ledger Controlling Account on the Private Ledger.

The scheme of control may be set out by the following pro forma schedule of accounts:

Private Ledger

General Assets	General Liabilities
General Ledger Control	Capital

General Ledger

Cash	Creditors Ledger Control
Customers Ledger Control	Private Ledger Control

Customers Ledger

Detail Accounts Receivable	General Ledger Control

Creditors Ledger

General Ledger Control	Detail Accounts Payable

In other words, the Private Ledger contains a controlling account over the General Ledger, and the General Ledger, in turn, contains a controlling account over the Customers Ledger and one over the Creditors Ledger. The Ledgers, therefore, are seen to be self-balancing.

§ 44. Private Journal

Auxiliary to the Private Ledger there should be a Private Journal, in which original entries can be made to eliminate them from the General Journal.

§ 45. Entries in Private Ledger—Current

Postings to the Private Ledger are made from the Private Journal. The regular books of original entry must be columnarized to accumulate the entries for the Private Ledger Controlling Account. Entries to the Private Ledger cover transactions which are not at all re-

corded in the general books and some which are recorded therein only in part. Entries to a Private Ledger during a current period are few in number at best. Money, for example, is borrowed upon a note. The recording procedure would be as follows:

General Books
Cash
To—Private Ledger Controlling Account

Private Journal
General Ledger Controlling Account
To—Note Payable

In this way, the source from which the cash came would not be disclosed.

Accounts receivable are not entered upon the Private Ledger. Sales as made are recorded in a Sales Book, a record of original entry. Daily, these sales are each debited therefrom to the various individual customers' accounts upon the Customers Ledger. Monthly, the total is debited to the Customers Ledger Controlling Account on the General Ledger and is credited to the Sales account. As each customer reduces his obligation by paying cash, entries are made in the Cash Book therefor and from there postings are made to the credit of the customers' accounts in the Customers Ledger. Again, at the end of the month, the Customers Ledger Controlling Account is credited, the Cash account is debited, and the Sales Discount is debited. Adjustments of customers' accounts must be recorded, likewise, both in the Customers Ledger and in the Customers Ledger Controlling Account in the General Ledger. At all times, in other words, the controlling account over the Customers Ledger, as found on the General Ledger, must in total be in agreement with the total of the detail account balances as found on the Customers Ledger. This con-

trolling account has a debit balance, and it is this debit balance which is equal to the amount of the debit excess found in the customers' accounts upon the Customers Ledger.

The Customers Ledger may be kept in balance by placing upon it a balancing account known as the General Ledger Controlling Account. This controlling account will contain a credit balance exactly equal to and offsetting the debit balance of the Customers Ledger Controlling Account on the General Ledger.

§ 46. Trial Balance

A Trial Balance should be taken of the General Ledger both before and after the nominal account balances have been transferred. An abstract is drawn from the Customers and from the Creditors Ledgers, in which the account balances are listed, and the total of each abstract is checked respectively against the balance in the Customers Ledger Controlling Account and the Creditors Ledger Controlling Account to see that each detail Ledger is in agreement with its General Ledger control.

When this has been done, these statements are handed by the head bookkeeper, the keeper of the General Ledger, to the person in charge of the private books. The latter takes them and with the amount of inventory on hand as a basis makes the proper entries upon the private records so that the Profit and Loss account may be set up.

§ 47. Entries in the Private Ledger—Closing

Usually, entries in a Private Ledger will be made at the end of a month. When the books are closed, the controlling account for the Private Ledger which is carried on the General Ledger should be treated as if it were a Profit and Loss account.

General Books

Close the nominal accounts, Purchases, Sales, Expenses, etc., after adjustment of them has been made,—excluding inventory, into the Private Ledger Controlling Account and leave them there. Analyze these entries for purpose of transfer to the Private Journal. For example, Sales account would be debited and Private Ledger Controlling Account would be credited.

Private Journal

Close these same accounts, and those relating to beginning and ending inventories. The entries for the accounts closed on the general books will be made in reverse order upon the Private Journal.

The Private Ledger will contain the periodical Profit and Loss account which is closed in the usual way into the Capital accounts or into Surplus. After all the entries have been posted, the Private Ledger assumes again the same appearance it had previous to the closing time, namely:

Debits	*Credits*
Various Assets (not accounts receivable)	Various Liabilities (not accounts payable)
General Ledger Control	Capital

§ 48. Illustration: Manipulation of the Private Ledger

For purpose of illustration, assume you are called upon to install and operate a Private Ledger in a small business, a Trial Balance of which, taken from the present General Ledger on December 31, 1919, is as follows:

Cash	$ 500.00
Cash Receivable Control	1,500.00
Notes Receivable	500.00
Inventory	2,000.00
Furniture and Fixtures	1,000.00
Buildings	5,000.00

Accounts Payable Control............		$ 3,000.00
Notes Payable....................		2,000.00
Capital		5,500.00
	$10,500.00	$10,500.00

New books are to be installed, including a Private Journal and Private Ledger which are to be kept by the proprietor. The regular bookkeeper will keep the general records. The Notes Receivable account is inactive.

First, an entry would be made upon the Private Journal to collect the Private Ledger accounts, so that the General Ledger will retain only the accounts of Cash, Accounts Receivable Control, Accounts Payable Control, and Private Ledger Control. The entry, omitting explanation, would be:

Notes Receivable	$ 500.00	
Inventory	2,000.00	
Furniture and Fixtures...............	1,000.00	
Buildings	5,000.00	
To—Notes Payable..................		$ 2,000.00
Capital		5,500.00
General Ledger Control.........		1,000.00

Second, an entry would be made upon the General Journal as follows, omitting explanation:

Cash	$ 500.00	
Accounts Receivable Control..........	1,500.00	
Private Ledger Control...............	1,000.00	
To—Accounts Payable Control......		$ 3,000.00

The posting of this entry would open the General Ledger. In addition to the accounts above shown, the General Ledger would contain the regular revenue and expense accounts.

Third, during the ensuing period purchases and sales and the other nominal items are entered upon the general books in the usual manner and are posted to the General Ledger to the regular accounts therein carried for the recording of these elements. At times during the period a transaction might take place which affects both the

General Ledger and the Private Ledger. Suppose the note receivable is collected; the entries would be as follows:

General Books		
Cash (Cash Book) ....$	500.00	
To—Private Ledger Control....		$ 500.00
Private Books		
General Ledger Control............	500.00	
To—Notes Receivable		500.00

Fourth, at closing time, all the nominal accounts as shown on the General Ledger must be closed into the Private Ledger Control in a manner so that the profit or loss for the period will not be indicated. On the private records these accounts are taken up in connection with the inventory facts and are handled in the manner usual for securing the net profit or loss. On the general books, the entry would be, omitting explanations:

Private Ledger Control
  To—Various Expense Accounts in detail
Various Income Accounts in detail
  To—Private Ledger Control

The posting of these two entries will close all General Ledger accounts except those first mentioned:

Cash
Accounts Receivable Control
Private Ledger Control
Accounts Payable Control

and perhaps certain items like Insurance Unexpired or Salaries Due and Unpaid. A Trial Balance of the General Ledger should be taken to prove the Ledger to be in balance.

Fifth, the Trial Balance of the General Ledger, before and after closing, is handed the proprietor, and he, with this information plus the closing inventory figure,

which he alone knows, closes the Private Ledger through the Private Journal in the regular manner in order to determine the amount of net profit earned, and to place the General Ledger Control in agreement with the Private Ledger Control. Variations in the above method are many, but the underlying principles are the same.

CHAPTER III

PROCEDURES, RECORDS, AND FORMS RELATING TO CASH

§ 49. Introduction

Thus far we have devoted our attention in the present course to a study of account classifications and ledgers. The third subject for consideration in our work on constructive accounting concerns the study of records of original entry. These records, ordinarily, are understood to be those in which the first systematic record, or diary, of business transactions is made based upon a predetermined scheme of classification of account debits and credits.

The subject is a large one, impossible of being discussed thoroughly from every angle in three or four chapters which at best can occupy but a few hours of a person's time. It is possible to devote months of productive thought to the subject of constructing records of original entry, especially as related to the large-sized types of business enterprises in which the records must be divided among a host of employees, must be controlled at every step, and must be taken care of in an efficient but economical manner.

In any enterprise, the records of original entry are subject to a three-way division, following the same division as is indicated by the lines of organization activity, namely:

1. Cash records. These are concerned with the recording of cash receipts and cash payments.

2. Purchase records. These relate to the records kept in which are entered purchases of materials, equipment, merchandise, and services.

3. Sales records. These refer to the records kept in which are entered sales of product.

These classes of records will be discussed in the order given above. However, before discussing the various rulings which may be used in connection with Cash Books, it seems advisable to devote one chapter to the consideration of certain general principles underlying the subject of Cash, which already has been somewhat summarily discussed in the preceding volume, in order to secure a background for the detailed specific consideration of cash records. Therefore, the present chapter is more or less general in nature.

§ 50. Money

Money is a measure of value, the same as a quart cup or a bottle may be a measure of quantity. Value is want attraction; an article has value because people want it. If people do not want a certain thing, that thing or article has no value to them; if nobody wants it, the article may have to be given away before it will change ownership. The value or worth of an article is measured by a fixed standard, which is called money.

Value is a relative thing. In the early days, one man would exchange, say, a rifle for a horse. Suppose, however, that the horse was worth a rifle and a half, of a certain make, or one of another make. Suppose, also, that the man with the horse wanted the make of rifle which was equivalent in value,—one and a half rifles for a horse. How could an exchange take place? Evidently, something was lacking; something was needed to carry such an exchange through to a successful conclusion. If the man with the rifle had something else of value which he

could give in place of half a rifle, the exchange could be effected.

Because of this, people began to hunt around to find this something which was needed to eliminate the deficiency existant. They hit upon the metals of gold and silver because the latter were held to be of value, they were produced in limited quantities, their permanency was lasting, value was great while size was small, and, people, in general, desired them. Therefore, in place of the half rifle, and in transactions of a similar nature in which an exact exchange of article for article could not be made, a certain amount of these metals would be given. The measuring out of these metals took time and, as a result, people eventually put them together in unit amounts, each unit having a certain value,—exchange value, which became known to all.

As a result, metallic coins were introduced to supplement values when articles could not be exchanged exactly unit for unit. When the plan was seen to work well, the barter stage of civilization gradually disappeared, and gold and silver were used in commercial exchange. Eventually, too, it became customary to exchange an article for a certain number of coins, because perhaps the person who took the coins had no present want to fulfill and took the coins so as to hold them until he desired some article to fill a want.

The coins so taken were easily kept, concealed, and protected for indefinite length of time, without there being much fear of fluctuation in their value as compared to that of actual goods. Still later, these coins were marked by some one in authority, and passed without question from hand to hand for the amount of value marked upon them. And still later, because even coins wear out by use and are inconvenient to handle where large values are involved, paper money took their place;

this was secured by metallic coins or metal in rough form (bullion) held by those in authority and retained by them in securely guarded vaults as a guarantee for the value of the paper. Therefore, at the present time, coins and paper currency are both used as value measures, and are unified in such a way that they set out and record a certain amount of value.

Gold and silver, because of their value, their ease of acceptance in commercial transactions, their small size as compared to the value they represent, and the desire of people to accumulate them, soon gave their owners and possessors a great deal of trouble; thieves made their appearance. Then certain persons respected in the community advertised that for a fee they would place the gold and silver of others in their strong boxes and guard these carefully from the ravages of thieves. Thus banks arose.

Eventually, these bankers found that the amount of money always on deposit exceeded the amount daily withdrawn by their customers, and that as a result a considerable unused balance accumulated. This balance these bankers began to loan out for a fee, with the result that a time arrived when they realized that instead of charging a fee to safeguard these treasures they could pay a fee to the owners of the money for the privilge of guarding it. Then interest developed and banks prospered. The latter kept on hand at all times only enough money to meet current demands, loaning out the rest at interest.

Subsequently, people realized that a certain amount of risk and inconvenience was experienced in passing out actual money from hand to hand. Therefore, the idea was brought forward of using what is now known as a "check" to expedite such matters and to eliminate the risk and inconvenience of handling the actual money.

§ 51. Credit and Banks

Credit may be defined as faith in business humanity. One man advances property values or rights to another upon the belief and faith that this other will return the value advanced at a later date, perhaps with interest added for the elapsed time. It may be said that character, cash, and credit go hand in hand.

All business houses have dealings with a bank. To summarize what has been said, the usefulness of a bank to a community may roughly be indicated as follows:

1. A depository for money
2. Collection of drafts and checks drawn on other banks
3. Sells its own drafts on other banks to facilitate out of town creditors
4. Discounts commercial paper
5. Issues paper currency to avoid the handling of gold and silver

If a person wishes to open an account with a bank, he must be introduced by some one already known to the bank. Then if he wishes to deposit a sum of money against which to issue checks, he must fill out a signature card, the signature or signatures thereon being those to be used in the signing of checks. Certain banks require a minimum amount below which the customers' deposits should never drop. When a deposit falls below this minimum, a monthly fee is charged the depositor for the banking service.

When a person opens an account with a bank, he is given a check book and a pass book. Deposits are made usually by means of deposit slips upon which the depositor writes his name and the date, and the amount he is depositing,—separating the latter into gold, silver, bills, and checks, the latter properly indorsed. The first three items are listed in total and the last—each check sepa-

rately. The deposit slip and the funds to be deposited are handed to the receiving teller who first checks the accuracy of the ticket total against the money and checks and who then enters the total deposit in the pass book, adding thereon, also, the date and his initials. Duplicate deposit slips may be retained by the depositor.

The pass book contains a record of the depositors' dealings with the bank. The entries therein are made from the viewpoint of the depositor—deposits are debited and checks credited. Periodically, the bank will balance the customer's account and return to him the canceled checks. The pass book may contain only a record of deposits; withdrawals in such case are copied onto a statement form from the customer's Ledger account in the Depositors Ledger, this statement being sent to the customer monthly.

§ 52. The Clearing House

If one tries to secure money upon a check by presenting it to a bank, he must be identified. This proves, at times, to be a cumbersome procedure resulting in a loss of valuable time and perhaps considerable annoyance. Therefore, it became customary at an early date that checks, when passed in the payment of goods, were taken by the receiver to his bank and deposited therein by him to his account.

Jones, for example, draws a check upon the Bowery Bank, in which he has money on deposit, and gives the check to Brown in payment for goods or services. Brown may live a long distance away from Jones. Jones deposits the check in his bank, the Union Bank. Eventually, the Union Bank must get this check back to the Bowery Bank. To do so, the banks meet in what is known as a "Clearing House" and exchange or offset checks one against the other,—clear their accounts, so to

speak. This is done daily. Suppose the Raymond Bank holds checks to the amount of \$50,000 drawn on the Union Bank; the Union Bank holds checks drawn to the amount of \$20,000 on the Bowery Bank; and the Bowery Bank holds \$30,000 drawn on the Raymond Bank. These checks are all turned over to the Clearing House, and the latter computes about as follows:

Raymond Bank	$+ 50,000 - 30,000 = +20,000$
Union Bank	$+ 20,000 - 50,000 = -30,000$
Bowery Bank	$+ 30,000 - 20,000 = +10,000$

The Union Bank would pay to the Clearing House \$30,000 in money, which amount would be turned over \$20,000 to the Raymond Bank and \$10,000 to the Bowery Bank. By this process, each Clearing House daily offsets a greater part of the banks' check transactions.

§ 53. The Check Book

Nearly every man in business understands the purpose of a check book, but many do not employ their check books to the best advantage. The general type of check with which every person is more or less familiar is prepared in a bound book, each sheet of which contains from one to five check forms with a certain amount of space at the left for entering a copy, in summary form, of the information set out upon each check. This information is to be written upon this open space after the checks have been detached therefrom; this part of the check is called the "check stub."

When a deposit is to be made, the detail of the checks and money to be deposited may be entered upon the reverse side of the stub and opposite the first blank check remaining undrawn. If there be too much detail, a separate memorandum book may be employed therefor and only the total shown upon the stub. The amount of each

deposit as entered upon the stub of the check book should be carried forward from page to page so that the complete total always will be opposite the next undrawn check. The total of the checks drawn during any period as shown by the record upon the stub should be carried forward from page to page until the pass book has been balanced and the reconciliation made, usually done at the end of each month. At the end of each month the total of the checks drawn is deducted from the total of the deposits made plus any credits at the bank during the month on account of money borrowed, and the new balance is brought forward upon the reverse side of the stub opposite the first check to be drawn for the next month. The balance to the credit of the depositor as shown by his check book at the beginning of each month is treated as a deposit carried forward. A simple calculation is all that is required to determine the bank balance at any specified moment of time.

One may, however, prefer to show in the check book at all times the balance against which withdrawals can be made. To facilitate this, a special column should be provided at the left of the deposit detail in which additions would be made of the total of each deposit and deductions of each check drawn. If no checks have been drawn, the last amount would be the total against which withdrawals can be made and, likewise, if checks have been drawn and properly entered the last amount shown in this special column would provide the same information.

The method of totaling the checks separately from the deposits is desirable to that of maintaining a running balance, as thereby the amount of the bank balance is not available to curious people; and should an error creep into the work, into the computation, somewhere in securing each total, the required changes will not be as many as when each check has been subtracted from the balance

on hand, said balance being figured each time a check is drawn.

Regular Form of Check with Stub Attached

No........			No........ Erie, Penna................19... THE FIRST NATIONAL BANK OF ERIE Pay to The Order of.................................... ....Dollars ....

§ 54. Check Book Stub with Columnar Ruling

When cash entries are few in number, the check book may be ruled and utilized to take the place of the regular Cash Book and the check book. Under this method no other Cash Book is necessary as the columns could be footed and posted, and each entry made could be explained fully. A record of household expenses may be kept in a very simple manner by having a book prepared as suggested above and entering therein all cash received and deposited and all checks drawn.

Check books of this type must be specially ruled. Frequently, check books are provided by banks without charge for the depositor, unless they are to be specially ruled and printed. A form of this ruling is shown below. As checks are drawn, the amounts are entered respectively in the "Net" column, the discount secured in the "Discount" column, and the gross amount of the invoice paid is entered in the "Gross" column. When cash is received, entry is made at once on the reverse side of the check stub in order to credit the person paying the money; the amount received is entered in the "Net" column, the discount, if any, in the "Discount" column, and the gross amount in the "Gross" column. All cash received must be deposited if the record is to be used correctly. Postings can be made in the same manner as though the book were a Cash Book, because, in fact, that

is what the stub of the check book has become. Such a check book should open flat; otherwise, it will be impracticable.

Check Book Stub Ruling—Face

Date	Explanation of A/C	Folio	Gross	Discount	Net Amount

Check Book Stub Ruling—Reverse Side

Date	Explanation of A/C	Folio	Gross	Discount	Net Amount

§ 55. Carbon Copy of Check Instead of Stub

When a large number of checks are drawn by hand, a carbon copy of each one may be retained instead of writing out a stub for each one. Such a check book has a blank sheet of paper bound in behind each sheet of checks. This blank sheet is blank in all respects except that it carries the check numbers of the checks composing the sheet in front of it. When a check is written, a sheet of carbon paper is inserted between the two sheets, a copy of the check being then made upon the second blank sheet. The checks drawn are detached from the check book along perforated lines; entries are made in the Cash Book at the end of the day from the information shown on each duplicate sheet. However, one vital objection to using this kind of a check book lies in the fact that the carbon copy of each check is apt to be indistinct; this may result in errors being made when the information contained on each duplicate is transferred to the Cash Book.

If a check book of this type is summarized daily upon a cash disbursement sheet to show total disbursements according to the account classification in force, time may be saved by eliminating the making of detailed entries in the Cash Book; again, if controlling accounts are carried upon the General Ledger, the information in respect to such accounts may be posted thereto from the daily summaries, the detail of the disbursements being posted to the underlying detail accounts. Similarly, the daily cash

receipts may be summarized after proper classification, postings being made from such summaries both to the General Ledger accounts and to the detail accounts upon the subsidiary Ledgers.

If daily cash receipts and disbursements are summarized as indicated, and postings are made from each daily summary, many General Ledger accounts would receive a large number of entries in the course of a month; this, as a rule, is not desirable. Since it is unnecessary, ordinarily, to post to the General Ledger accounts daily, the number of postings to the General Ledger accounts, as indicated above, may be reduced by entering the totals from each daily summary upon a monthly summary sheet, one line being used for each day. At the end of the month, the columns of the monthly summary are footed, and postings therefrom made to the General Ledger; in other words, monthly postings to the General Ledger replace daily postings thereto.

§ 56. Voucher Check

An ordinary check does not set out the payment for which the check is given; therefore, it is unsatisfactory as a receipt. A creditor, without instructions to the contrary, may apply the amount of a check received by him as he sees fit. As a result of the ordinary check being unsatisfactory as a receipt, special forms of checks are oftentimes used, called "voucher checks" upon which space is provided for showing the items its payment covers. The forms in use are many, some simple, and others cumbersome. They may be of standard check size, or they may be of double standard size, being folded over so that the check part is at the bottom and so that, on the whole, they will conform to a standard check size.

The voucher check should not be confused with the voucher system, since the voucher check may be used

therewith and it may not be so used. If so used, the check should indicate the voucher for which payment is made. Indorsement of a voucher check by a creditor is sufficient receipt for payment of the items set forth in it. A form of voucher check is shown below.

There are many types of checks employed in business enterprises, each one having been prepared, perhaps, with some particular purpose in mind. But enough has been said above to indicate the general possibilities underlying the subject of checks. A few more ideas will be presented on the subject of checks when the discussion on voucher systems is reached.

Voucher Form of Check

STATEMENT OF ACCOUNT

DUPLICATE MACHINERY COMPANY
23 Madison Avenue
New York, ...No.........
Due.............................. $.... .....
.... Dollars
in full payment of account stated in margin.
This voucher when indorsed properly, and without alteration or erasure, becomes a check payable at

Countersigned
....
Cashier
Voucher No.........

NEW YORK BANK
New York

Treasurer

§ 57. Bank Reconcilements

When the pass book is balanced at the bank, or a monthly statement of account is received from the bank, the balance of cash on hand as shown by the Cash Book, or check book, should be compared immediately with that shown by the bank, to see that everything is in proper order.

In the Cash Book, every issued check to settlement date has been deducted, whereas, on the bank statement, there would appear only the checks presented to the bank for payment. Certain checks might be, and usually are,

outstanding. Again, in reconciling, attention must be taken of such items as exchange and interest which the bank might have included in the determination of the cash balance, but which have not been entered on the Cash Book, or check book. In other words, the cash balance as shown by the Cash Book must be reconciled with the cash balance as computed by the bank. In reconciling the Cash Book balance with that shown on the bank statement, one should work always toward determining the accuracy of the actual amount of cash on hand.

The following form of cash reconciliation statement is suggested:

Bank Reconciliation

Balance, per Bank Statement...........................		$ ¢
Add		
Deposits per cash book not on bank statement...........	$ ¢	
Collection or other bank charges not entered on cash book at date of reconciliation...........................	$ ¢	$ ¢
Deduct		$ ¢
Checks issued, entered on cash book but not shown as paid on bank statement..............................	$ ¢	
Interest allowed by bank not entered on cash book at date of reconciliation..................................	$ ¢	$ ¢
Balance, cash balance per cash book......................		$ ¢

§ 58. Precautions for Safeguarding Cash

Great care should be observed in accounting for cash. When cash is lost or stolen, the amount so lost or stolen is difficult to trace. Cash does not take up much room,—it is hidden easily; and it is a current medium of exchange. Other assets, such as merchandise and supplies, cannot be so easily disposed of and hidden as can cash,—an asset of large value in small bulk. No matter what precautions are taken to safeguard assets, and especially cash, certain losses may result; but as many safeguards as possible should be used to reduce to the smallest degree the chance of a loss taking place. Any employer

who does not provide the safeguards necessary to make the peculations of cash a difficult matter is really an accessory to the crime when cash is stolen.

Before establishing a system of cash records, one or two points of organization detail should be kept in mind and applied to the case in hand where possible. The receiving cashier's duties and functions should be separated from those of the paying cashier. And in his turn, the paying cashier's duties should be so subdivided that as much as possible his payments will be made by check, and that for small payments, the sums paid out will come from a separate fund kept for that specific purpose by another person. All cashiers should have access to no records of any kind other than their own Cash Books.

In a retail establishment, cash registers are useful in safeguarding the cash receipts. One or more may be used in each department, and at the end of the day just before the bank deposit is made up,—which may be about 2 p. m., the registered total in each machine is checked, first, against the cash in the drawer and, second, against the cash sales reported by the salesmen in each department. When checks are received by mail in payment of accounts, the person who opens the mail,—usually a trusted employee having no other connection with the cash system routine, and before the cash so received is turned over to the cashiers, makes a record of the cash received by mail on a sheet of paper called a "cash blotter," containing spaces for name of remitter, address, amount, and reason for remitting. This record is used later in checking up the cashiers' daily reports. The sheet may be made out in triplicate. One copy is sent to the manager, one is sent the cashier accompanied by the remittances, and one copy is retained for audit purposes. By so handling the matter, the letters themselves may be sent to the proper departments for consideration.

Payments of cash are safeguarded by supporting vouchers. A voucher is a document the contents of which verify and certify that charges for values are paid out or parted with, and that credits for values received are correct. Each voucher should be approved by a responsible official before payment is made, after he has examined into the reasons for making such payment. Such examination, as a rule, amounts to seeing whether or not the voucher carries the O. K. of the proper sub-official.

The organization detail pointed out above in connection with the precautions to observe in the establishment of a cash system, divides the required accounting work into three major divisions or steps:

1. All cash receipts should be deposited intact in the bank at the end of each day.
2. All cash payments should be made by check when possible. The first two points taken together provide a double record of cash—a record of its receipt and one of its payment; the bank makes one record and the cashier makes the other. One is checked against the other to detect discrepancies.
3. All petty cash payments, as for carfare, postage, etc., for which checks cannot be issued, should be handled from a petty fund operated on the imprest basis.

When cash receipts are deposited intact daily, it is an easy matter to trace them into the bank with accuracy; without so doing, it is impossible to account accurately for all cash received in the course of a day—petty stealings will be difficult to trace. The bank pass book, or the monthly bank statement, contains a record of all cash receipts; this may be checked against the receipts side of the Cash Book both in detail and in total, making it possible to secure full accountability for cash taken in. This is because the Cash Book becomes a detailed record

of bank deposits. A further check in this connection is secured by obtaining a statement from the bank certifying to the balance there on deposit.

When cash payments are made by check, no disbursements of any kind should be made over the counter from the receipts fund. The bank statement and the canceled checks may be checked against the payment side of the Cash Book. This side of the Cash Book is a detailed record of bank withdrawals agreeing in every particular with the record as contained upon the bank statement. Whenever a check is issued, a receipt should be required from the recipient; a check by itself should not be considered as a sufficient receipt. The receipt may be made part of the check, in which event we have a voucher check, already described above.

When disbursements are by check, each check drawn must be entered on the Cash Book and must be accounted for. Checks should be entered in numerical order, and if a check is spoiled, such spoiled check should be entered in its regular turn with complete explanation. The amount of such check had better be left blank,—not entered. If its amount is entered, the same check must be included in the deposits for the day and be passed through the bank. In the latter case, the deposit and the check are not posted, and each entry should be marked ''contra'' to indicate such handling. Since deposits and payments are inflated by such procedure, such handling is not advisable. Of course, since the bank record shows the same amount of inflation, the checking system does not fall through. The new check is entered in the ordinary way.

Handling checks by the ''contra'' method is satisfactory when checks are exchanged for cash, when checks are cashed from the cash drawer, and when cash is returned to the sender of a check who sends in a check too large in amount for the debt he owes.

§ 59. Petty Cash Fund

All payments conveniently cannot be made by check; some must be made in actual currency. And a system should be followed out in this connection. The simplest way is to set aside a certain sum sufficient, say, to last a week; a check is made out to "Petty Cash" for the sum agreed upon, and this sum is charged to a Petty Cash account carried upon the General Ledger. The amount of this fund remains unchanged unless increased or decreased. This check is cashed at the bank or by the receiving cashier. If the latter cashes the check, he places the check with the others in his cash drawer and deposits it with them as part of the day's receipts. This money is then given to the person in charge of the petty fund,—the petty cashier, who is responsible for its being handled properly. The petty cashier must always have on hand the full amount of the fund of cash, or cash and approved receipts in total equal to the amount of the fund. At the end of the week, the one in charge of the petty fund makes up a recapitulation statement of his disbursements showing the accounts to be charged therefor, and this, supported by the receipts (petty cash vouchers) he has taken from the recipient of each separate petty cash payment, he turns over to the proper official, or perhaps to the regular cashier. The regular cashier then draws a check for the amount of the disbursements made, entering same upon his Cash Book by charging the various accounts as set out in the statement handed to him and crediting the bank. The latter keeps the statement with its accompanying vouchers as his authority for issuing the check. This check he turns over to the petty cashier who, after he has cashed it, has his fund once more at its original amount. When the fund is extinguished, the petty cashier turns over the vouchers in his possession

plus the cash remaining on hand, the general cashier debiting Cash account and the various other accounts as necessary, and crediting Petty Cash account. The Petty Cash account is an asset account handled as such on the Balance Sheet. In connection with this petty cash fund, a Petty Cash Book is kept; this record is described later.

Another method of handling petty cash is frequently used, but this is loose, inaccurate, and unsatisfactory. The check establishing the fund is charged at once to an expense account, and no further accounting record is made. The idea in mind here is that since the money is to be used for petty expenses the time of charging out its amount matters not.

§ 60. Working Fund Versus Petty Cash Fund

A working fund differs in certain particulars from a petty cash fund. A working fund is established for the purpose of advancing cash to some employee or to a branch office or factory at a distance from the main office so that certain disbursements may be made therefrom by the employee or branch or factory office for current expenses. A petty cash fund when depleted or nearly so is reimbursed for the amount of the depletion upon receipt of vouchers supporting the disbursements. A working fund is not revived to its original amount by a reimbursement. A sum of money is advanced to the working fund, and when payments therefrom are made and reported, the fund account is credited. The fund may be increased over its initial amount by receipts of cash from various sources. When the fund is low, more cash is advanced as requirements call for. The fund is usually large in amount as compared to the petty cash fund, so large at times that payments therefrom are made entirely by check.

§ 61. Other Items Not Included in Cash

Trust Funds. A trustee should be careful to keep all trust funds entrusted to his care separate from his own cash funds, in order to reduce his personal liability in relation thereto. Such funds should be deposited in a separate bank account and such account should be earmarked so that its title will show clearly its nature, as "Estate of John Smith, A. Doe, Trustee."

Certificates of Deposit. A certificate of deposit represents cash which has been deposited in a bank either because for safety where a checking account is not wanted, or because of the interest such a deposit will draw. Certificates of deposit are not part of the regular cash balance and, therefore, should be carried in a separate account. Income therefrom is not operation income; neither is income from the regular checking account operation income.

I. O. U's. I. O. U.'s include the personal tickets of employees and of the management representing their drawings from the business cash, usually against future salaries. They should not be considered as cash, being in the nature of notes receivable. The habit of permitting their use is a bad one and should be discouraged. If used, they should be carried in a separate account, as charges thereto; when a salary becomes due its amount should be credited to this account and a check then should be drawn for the difference in the employee's favor, if any exists. The slips may then be returned to the employee when the check is given him.

§ 62. Commercial Discounts

The term "discount" may be defined as a deduction of a certain amount per cent. specified from a principal sum owing or to be paid. Bank discount is a percentage charge for the interest on money advanced on a bill or

other document due at a future date. When a person borrows money by discounting a note at a bank, he receives from the bank the present value of the note as proceeds; the amount of interest the note will earn from discount date to maturity at the rate specified is deducted from the face of the note, and the borrower receives the reduced amount, its present value. Stock discount is the difference between the par or face value of shares of stock sold and the actual amount of cash, or equivalent, received for them when the stock is sold for less than face value. The reverse of this procedure would produce stock premium. True discount and bank discount are practically the same. It represents the difference between the present value of a note or document and its face value at maturity, interest being calculated at a certain specified rate per cent.

Manufacturers, wholesalers, publishers, and others, when printing catalogues have fixed nominal prices for the goods listed therein, a basic figure upon which sales price is calculated. Such prices are called "list" prices. Market prices fluctuate constantly, making it impossible to set in any catalogue a price which soon will not require adjustment. A new catalogue cannot well be printed whenever a change is price takes place. Therefore, when the market price changes, extra sheets are published at small expense in which price adjustments based upon list prices are made by means of percentage rates. List prices would be used, also, where secrecy as to actual prices is desired. When prices increase, the discount allowed is less; when they decrease, the discount from list price increases. Such deductions from list prices are called "trade accounts."

An increased discount is secured by offering a second discount to be deducted from the list price after the first one has been deducted. Two or more discounts are called

a "discount series." Prices may be quoted at a single discount or by a series, each having as its basis the net amount left after deducting the previous discount. The order in which trade discounts are deducted is immaterial,—10%, 20%, 10% off is the same as 10%, 10%, 20%, for example. Trade discounts should not be entered upon the books—the net price being entered thereon only. Trade discount is deducted from the face of the bill and the net resulting selling price shown is the price entered in the Purchase or Sales Book.

A "cash discount" is the discount offered by the seller for prompt payment of bills within a short prescribed period of time. It is the inducement offered by the seller to the purchaser for prompt payment at an earlier date than payment would be made were no inducement offered. Cash discounts are small, ranging from 2% to 5%, depending upon the line of business. Cash discount is not trade discount; the two must not be confused. Cash discount appears upon the books of account.

There exists some disagreement as to whether cash discount should be considered as a reduction in price or as an expense of business management the same as interest. However, one cannot go wrong if he adopts the latter view. Discount transactions relate to the financial side of the enterprise; if given, they are a financial expense, and if received, they represent financial income. (See Classification of Accounts, Chapter 1.)

Trade discounts are calculated in many ways; the following illustrate some of them:

1. If a discount series consists only of two discounts, a single rate equivalent to the two may be used:

Example: The discounts are 20% and 10%.
$.20 + .10 = .30$; $.20 \times .10 = .02$
$.30 - .02 = .28$. Equivalent rate is 28%.

2. If a discount series consists of more than two:
   Example: The discounts are 10%, 20%, 10%.
   - 10% discount is equivalent to 90% of list price
   - 20% more discount is equivalent to 80% of the new base of 90% first secured
   - 10% more discount is equivalent to 90% of the new base of 80% secured secondly
3. The usual simple method:
   Example: The discounts are 10%, 20%, 10%.
   Deduct 10%, then 20% from the new base, and then 10% from the second new base.

§ 63. Records of Original Entry

At present, original records may be found in numberless forms, loose memorandum sheets, formal vouchers, and perhaps some in the form of tickets. Some form of memorandum is used upon which to place the original record of a business transaction, prior to its being placed upon a journal entry record. These original memoranda are temporary in character, and if not desired later for audit purposes are destroyed as soon as their usefulness is completed. In many instances, however, these original memoranda sheets are placed together in a loose binder cover and then take on the character of a Journal, being used from which to make postings to the Ledgers.

These original memoranda may be in small compact form called "tickets," a ticket being made out for each transaction. These tickets are sorted periodically in any way desired for posting purposes, the postings being made directly from the tickets. One arrangement would be to assort and arrange the tickets according to each record of original entry to secure the figures therefor, and for the controlling accounts; then they could be reassorted according to ledger accounts for posting purposes. After the posting is completed, the tickets may

be filed away in a regular filing system or be tied up in bundles and stored away.

Duplicate copies of original memoranda may be made by the use of carbon sheets at the same time as the original is prepared. This makes for accuracy and the consequent elimination of disputes. As many copies may be made at one operation as is desired.

§ 64. Accounting Forms and Records

Whenever a certain form or record is used in a system of accounts, such use is one of convenience only, nothing else. A form may be a blank sheet of paper as well as one containing lines and certain rulings. These lines and rulings, likewise, are a matter of convenience. The convenience of certain forms has been so well established that now they are considered as standard, and always appear the same unless their usefulness in some other form has been clearly demonstrated. When the latter is the case, custom should be discarded quickly and without fear.

Whenever a form is designed for a system, great care should be observed in its construction. The end always should be kept in mind, and the form be used as a means of securing the end desired. All forms should help in cumulating facts which eventually will be allocated to the major accounting statements and the sub-statements akin thereto. Therefore, as has been said many times, the basic statements eventually to be prepared must at all times be kept in mind when designing a form.

A form should be as simple as possible. Elaborate forms are to be deplored, if absolutely unnecessary. Two forms should not be used when one will suffice. Every form should set out the information wanted and needed, nothing else. Each one should fit into the sys-

tem as a means for the securement of the end. At times, a form may be transplanted bodily from one system to another, but such instances are rare; material changes, as a rule, will be necessary, even though the basic idea remains the same. Each form problem requires individual solution. The more elaborate and detailed the system, the more forms are required. Every form must be based upon a satisfactory routine. If the routine used for gathering, classifying, recording, and reporting information is incomplete, a form based thereon will be a failure. In this respect, experience is the only teacher.

Forms should be uniform in make up and size as much as possible, so that identification troubles, confusion, and the making of mistakes are reduced to a minimum, and so that filing space is conserved. Even though one form should be used, if possible, in preference to two, it should be remembered that too much detail should not be placed upon any one form. This tends toward confusion, and the passing over later of essential information contained thereon. Only a limited amount of material can be grasped by the eye at any one time. If possible, one form should be used for more than one purpose; if inadvisable to use one copy for two purposes, have two copies prepared, each of a different color, perhaps, one to go to one place and the other to go to the other place. It is the use which is to be made of a form rather than the use which may be made of it that should be kept in mind at all times.

Other things to remember in preparing forms and records may be set out as follows: Will a saving ensue from its use? Is it complete in all details? Where will it be used—exposed to the elements or indoors? Is it to be written up with a pencil or with a pen? Is it to be used only temporarily or is it to be used a long time and be continually referred to? How many persons will use

the form? What information must the form contain, and which of this is of major importance and which of minor importance? Full consideration must be given these details so that the form may contain all necessary information.

A form or record, at best, can contain but a limited amount of information or figures from right to left, whereas, from top to bottom the expansion is practically unlimited. From left to right a form or record cannot reasonably contain more than 40 or 50 columns, whereas, as many sheets may be used as is necessary—1000 if need be.

The column is the unit of construction on a form or record. A column was defined in a preceding chapter as a certain amount of paper space bounded by vertical lines and cut as often as desired by horizontal lines upon which the writing is aligned. These horizontal lines should not all be of the same color, especially when the form or record is of fair size. As a rule, every fourth or fifth horizontal line is ruled in ink different in color from the others, these differently colored lines acting as guide lines for the proper allocation of the writing and figures to their proper position upon the form.

Fixed classifications and groupings should be arranged from left to right, whereas, varying classifications and groupings should be placed in order from the top of the sheet downward to provide for expansion. Forms should be of such size that when cut by the printer, paper is not wasted. Large paper sheets come in certain sizes and when cut, the cut sheets should be of such size that they are a certain uniform part of the whole sheet. Care should be observed, also, in this connection, to see that the proposed form will fit the top of the desk of the person who is going to work on it, and that, when in its binder, it will fit the safe depository in which the records are kept over night.

§ 65. Loose Leaf and Card Records Versus Bound Books of Original Entry

In the preceding chapter considerable space was devoted to a discussion of loose leaf and card Ledgers. The principles therein brought out should be reviewed in the present connection because they apply as well to records of original entry as to Ledgers.

In a loose leaf record the sheets are not bound together by staples or sewing. They may be removed and rearranged as desired. Loose leaf records are used to a great extent, so much so, that without due and careful consideration of the case in hand, they may be used throughout a system when in fact such generous use of this type of form may not be correct. A loose leaf sheet usually contains perforations along one edge to fit in rings or over binding posts which are either of metal or leather. Some loose leaf records may be locked in their covers so that pages cannot be abstracted without the use of a key. In such case, the key should be retained in the possession of a responsible employee, and then, to all intents and purposes, the record is a bound record, so to speak, until unlocked.

In a large organization, the subdivision of labor in bookkeeping which permits one employee to check the work of another permits practically the indiscriminate use of loose leaf records. Sheets are easily arranged in any way desired for work thereon. The size of a loose leaf record in actual use may be kept small by taking out the filled sheets, and by not putting in the empty ones until they are to be used. More than one person can work on the record at the same time by distributing the sheets among the workers. Since the cover is a loose one, it may be used a number of years even though the sheets are replaced a dozen times. Unused space is not wasted. Duplicate copies of each record may be made at

the same time that the original copy is made. Posting is facilitated; the sheets written up one day may be posted the next without hindering writing up the new sheets the next day.

On the other hand, sheets may be substituted easily, and assist in perpetrating fraud, although a proper audit should disclose the fraud regardless of whether the record be loose leaved or bound. Every sheet should be strictly accounted for, even though spoiled. Unused sheets should be locked up and placed in possession of a responsible person who issues them only upon proper requisition.

Loose leaf original records may be either in sheet form or in card form, although, in general, cards are more appropriate on which to record ledger accounts than to be used in a record of original entry. Each case must be taken by itself and a decision reached as to whether or not a loose leaf record will suffice. In a one man concern, all records preferably should be in bound form so that the abstraction of sheets cannot occur. Of course, an entire record may be substituted temporarily for one fraudulently kept, but such a proceeding is no more apt to occur than the substitution of one loose sheet for another. The General Journal, preferably, should be in bound form, because Journal entries are, as a rule, made independently from others—are unusual in character.

As a rule, bound books are used in records of original entry, although one often finds the Purchase Journal, Voucher Register, and sales Journal in loose form, especially where such records contain a voluminous number of transactions. As said before, each case coming up for consideration requires an independent decision as to whether or not a bound book or record is preferable to a loose leaf one.

§ 66. Record Expansion by Columnar Process

In one of the former chapters, Volume No. 1, Chapter 15, it was stated that bookkeeping may be carried on with only a few books, in fact, with only one Journal and one Ledger. Present day accounting records have not really resulted in better methods; but they have resulted in methods which are more economical than those used in the past. One man at present may do easily the work formerly done by two.

When all entries are made only in a Journal, the transactions therein entered concern receipts and disbursements of cash, the purchase and sale of merchandise and other things, notes, expenses, adjustments, and closing entries. As the volume of the business increases, the use of only one Journal as a record of original entry becomes more and more inadequate, until a point is reached where one person cannot record all the transactions in one book, and keep the work up to date. Because of this fact, separate records of original entry have come into existence, the separate resultant records being about as follows:

1. Cash book
2. Purchase book
3. Sales book
4. Bill books (note registers)

In each of the cases mentioned some particular class of items is removed from an account in the Ledger and their total is substituted in place of the group of detail items. In most instances, only the details of one side of an account are removed in place of which totals are entered to represent them. In certain other instances, practically all of the account,—both debits and credits, are removed, as is the case with the Cash account. What remains in the Cash account at best are figures represent-

ing the beginning balance, total receipts and total payments for a period.

The simple Journal has been developed from the single entry Daybook. The columnar Journal was evolved from the combined Journal and Daybook. The columnar principle has been utilized in separating the Cash Book, the Purchase Book, the Sales Book, and other records of original entry, from the Journal. These separated records are but parts of the Journal each with columns for the special class of transactions that give the new book its name.

§ 67. Columnar Journal Defined

A columnar Journal may be defined as a book of original entry,—a Journal—in which columns have been introduced in order to classify therein the frequently recurring transactions with the object in view of lessening the number of postings.

Columnar Journals are of many kinds, the ones frequently met being as follows:

1. Cash book
   - (a) Receipts register
   - (b) Payments register
2. Purchase book
3. Voucher register
4. Sales book
5. Notes receivable register
6. Notes payable register
7. Insurance register
8. Account sales register
9. Purchase returns book
10. Sales returns book
11. General journal

All columnar Journals must make possible the securement of an equal debit and credit for each entry therein. The special columns may be regarded as temporary

places in which are grouped like items of frequent recurrence. At the end of each period, monthly or otherwise, the columns are footed, and the posting carried out, as will be described subsequently.

§ 68. Accounting on Cash Basis Versus on Accrual Basis

Cash includes all values which a bank will receive for deposit, such as money, checks, drafts, coupons, etc. Cash is an asset,—a real element, which in amount fluctuates rapidly; it is perhaps the most active asset a business has.

Basically, the bookkeeping record of cash contemplates a record of incoming cash items offset by a record of outgoing items,—in other words, a record of cash receipts offset by a record of cash disbursements. As long as a business is conducted absolutely in every particular upon a cash basis, a Cash Book would be all sufficient for the recording of the business income and expense, and if properly kept it would be possible to secure therefrom a complete analysis of all income and of all expense. However, such is the exceptional case, not the usual one.

When a sale takes place, the payment therefor may not be then and there made; usually, it is not. Under such a condition, since it is necessary in good accounting to record income as it accrues, the Cash Book falls short of being used as a record in which all income may be entered; the credit element entering into such transactions makes it necessary to provide two separate and distinct forms in which to enter income transactions:

1. Cash basis income
   - (a) Cash book, receipts side, or
   - (b) Cash receipts register
2. Credit basis income
   - (a) Sales book

Sometimes, it will be found that all income is first re-

corded in a Sales Book of some sort, and that therefrom the cash income is transferred by daily totals to the Cash Book. The Sales Book is discussed later in this volume.

Likewise, when a purchase is made, whatever it may be,—wages, goods, supplies, etc., it is usual once in a while, at least, not to pay cash down therefor. This condition, also, makes it impossible, as a rule, to make use of the Cash Book as a record in which all purchases may be made; credit purchases cannot be taken care of thereon in a practical manner. The credit element again, since it is necessary in good accounting to record expenditures as soon as the liability to pay therefor accrues, makes it necessary to provide two separate and distinct forms in which to enter purchase transactions:

1. Cash basis purchases
    (a) Cash book, payments side, or
    (b) Check register
2. Credit basis purchases
    (a) Purchase book, or
    (b) Voucher register

When income is recorded only as actually received in cash, and purchases are booked only as payments are actually made to creditors, the accounting system is said to operate on a cash basis. In non-profit organizations, as a charitable institution, this type of system is common. In such cases, the accounts receivable and payable outstanding are entirely ignored. From a set of books kept in this manner, the regular accounting statements, as we understand them, are not usually prepared, the only statement in use, as a rule, being the Statement of Cash Receipts and Disbursements; at least, the latter statement is all that can be prepared from the books as kept. In such cases, the Cash Book in use is very much columnarized.

When income is recorded as it accrues, and pur-

chases are booked as the liability to pay therefor is incurred, the accounting system is said to operate on the accrual basis,—income and expenditure basis. This is the correct basis upon which double entry records should be operated. From a set of books kept in this manner, the regular accounting statements may be prepared whenever desired,—the Balance Sheet, and the Statement of Profits and Income (statement of income and expenditure). If desired, the Statement of Cash Receipts and Disbursements may be prepared to accompany the Statement of Profits and Income.

CHAPTER IV

PROCEDURES, RECORDS, AND FORMS RELATING TO CASH (*Continued*)

§ 69. Separate Cash Treatment Required

Cash transactions outnumber all others, as a general rule; this has been mentioned before in the first volume. Because of the large number of cash transactions, both receipts and payments, the posting labor connected therewith, when a simple Journal is used, is voluminous. Therefore, some means had to be devised to eliminate a portion of this heavy labor. Again, a certain amount of cash must be on hand at all times to meet current payments of various kinds, and care must be observed to see that a correct and sufficient amount is on hand. A business cannot well hold up its credit by being careless in this respect; overdrafts on the bank—overdrawing the bank balance—would be frequent, resulting in the bank's eventually refusing to do business with the concern. Again, a business must be decidedly small not to require the services of one person exclusively to handle cash transactions. All of these reasons are grounds for according separate treatment to cash, and for requiring cash records to be built so that one person at least may devote his entire time to them.

§ 70. Cash Record Development

Cash transactions may be recorded in any one of the following ways, proceeding from the simple record to the complex:

1. The simple journal. Herein cash transactions are entered with all others.

2. The simple cash book. One page is used for receipts and one for payments, in alternate order. The ruling is similar to that of a simple journal.

3. The columnar cash book. This is an elaboration of the simple cash book by the addition of columns, each to hold a separate group of like items.

4. A separate record for receipts and a separate record for payments:

 (a) Receipts register
 (b) Check register

§ 71. Two Column Journal and Cash Book

Because of reasons already set out, the item of cash requires certain distinctive treatment. For such distinctive treatment, a separate Journal or Journals are used, the simplest form of which has already been described in the preceding volume. Cash transactions are entered in this Journal or Journals directly, and from thence posted to the Ledger account of Cash.

In certain instances, due to the fact that a Cash Book takes the form of a Cash account, this cash record combines both the functions of a record of original entry and the Ledger account of Cash, no Cash account being carried on the Ledger; when such is the case, care must be observed to include the cash balance from the Cash Book in the Trial Balance, in order that the latter will balance. However, no reason exists for handling Cash in this manner. All accounts should be found upon the Ledger, and none should be found elsewhere. If a record is a Journal, it should be used as a Journal to avoid possible confusion, if for no other reason. A Trial Balance is prepared from a Ledger and nothing should appear therein except amounts found upon the Ledger. The advantage of carrying a Cash account on the Ledger is especially noticeable when taking off a Trial Balance in a

case where the General Ledger keeper does not keep the Cash Books.

In the simple Cash Book, one page devoted to receipts is followed immediately by one page for payments; this has been commented upon before. Debits to Cash are entered upon the debit (left) side of the Cash Book, and credits to Cash are entered on the credit (right) side. When Cash is debited, the account to be credited is entered likewise with full explanations therefor, and when Cash is credited, the account to be debited is entered in a similar manner, with full explanations. The beginning balance plus total receipts minus total payments indicates the balance of Cash on hand, if a debit balance; and if a credit balance is shown, an overdraft is indicated.

When a simple Cash Book is used,—the two column Cash Book,—every item found on either side thereof must be posted to the opposite side of some other account in the Ledger; and to keep the Ledger in balance, the total of the respective sides must be posted to the same side of the Cash account upon the Ledger.

The principles underlying the use of a Cash Book may be summarized as below:

1. When an amount is entered on the left or debit side of the Cash Book, the Cash account is debited automatically.

2. When the name of an account is placed on the debit side of the Cash book, that account is credited by such placement.

3. When an amount is entered on the right or credit side of the Cash Book, the Cash account is credited automatically.

4. When the name of an account is placed on the credit side of the Cash Book, that account is debited by such placement.

The advantages of a Cash Book are as follows:

1. The simple Journal is relieved of cash transactions.
2. Cash transactions are grouped in one place.
3. The cash balance may be determined without the necessity of posting the Cash Book.
4. Posting is facilitated, because only one posting to the Ledger need be made for cash receipts and one for cash payments, for any one period of time,—as for a month.

§ 72. Columnar Cash Book

Many of the postings from the Cash Book concern similar items, for example, payments made by customers on account and cash sales items on the debit side, and payments to creditors and expense items such as freight, express, general expense, etc., on the credit side. In the simple two column Cash Book each item must be posted in detail to its individual account. However, it was found that many of these items were not needed daily in the Ledger, and as a result some of them could be held suspended in like groups in separate columns added to the original ones and be posted therefrom in totals once a week or once a month. When this is done, no matter how many special columns are used, one column should be used in which to record net receipts and one net payments so that the net balance of Cash may be secured readily, and so that the distributions may be checked against the total or "net cash" column.

Income items, as a rule, are not classified to any extent upon the Cash Book, unless an enterprise is run entirely on a cash basis. The columnar development concerns mostly the customers' and creditors' accounts,—for control purposes, and for discount transactions.

§ 73. Recording Cash Discounts

Assume a number of customers of a certain merchant discount their bills, and that he, in turn, discounts a num-

ber of his bills. In each instance, the amount of cash involved is somewhat less than the amount of the account which it was intended to pay. As a result, a credit or debit of some kind is necessary to make up this difference. The methods of handling this problem are about as follows:

1. An adjusting entry could be passed through the General Journal individually, and if the items of this type were numerous, a page or two could be set aside in the Journal for this purpose, so that at each posting date the debit and credit column could be added and one posting made for each total. This method has its objections because it permits cash transactions to be diffused—entered in books other than the Cash Book.

2. Each discount credit item could be passed through the Cash Book as a receipt and each discount debit item could be passed through the Cash Book as a payment. This method eliminates the major objection to the first procedure above, but by its use the total receipts and total payments are seemingly inflated and, as a result, tracing the cash in and out of the bank is not expedited, even though the cash balance on hand is ascertained as usual. Neither side of the Cash Book accurately displays the receipts or disbursements and any attempt to use these totals for such purpose would be wrong.

3. Discount columns are carried on the Cash Book either as regular cash columns or as memoranda columns:

a) Cash columns. The number of postings to each personal account is reduced by making one posting of the gross amount instead of two postings—one for Cash and one for Discount. The discount columns are transferred to opposite sides of the Cash Book and are used in connection with the Cash account. The Cash account is charged with the gross amount and on the oppo-

site side of the record Cash account would be credited to adjust the difference between the actual cash received and the amount recorded.

b) Memoranda columns. This method is the most satisfactory of all. Each memorandum column for discount appears on the same side of the Cash Book as does the entry showing the actual amount of cash received, this actual amount received, or paid out also, being the amount of cash entered in the Cash Book. The items in the Discount columns are posted individually to the respective Ledger accounts and the total of the columns is posted either to "sales discount" or "purchases discount" account, depending whether a sale or a purchase is involved. When the Cash Book is balanced, the discounts do not enter into consideration at all. This method facilitates the audit of Cash, tracing the cash in and out of the bank being made relatively easy thereby, and permits each personal account on the Ledger to show exactly how the account was settled. A Cash Book with memo columns of this type is shown below.

Cash Book—
Receipts Side

Date
Particulars
L. F.
Accounts Receivable
Discounts Allowed Sales
General
Net Cash
Deposits

Cash Book—
Payments Side

Date
Check No.
Particulars
L. F.
Accounts Payable
Discounts Received Purchases
General
Net Cash
Checks Drawn

§ 74. Bank Columns on the Cash Book

The bank account may be kept in a number of ways. The check stub may be the only record, the entries being made either upon its face or back. When entries are made upon the face of the stub, the common procedure is to subtract each check from the preceding balance so as to show the new balance. When the back of the stub is used for the bank record, or a sheet is bound beneath each blank check to secure a duplicate copy of the issued check, the deposits would be carried as one group separate from the checks carried as another group; this has been indicated previously.

Frequently, the Cash Book contains bank columns, one or more on the receipts side for deposits and one or more on the payments side for checks drawn. When such is the case, the check book stub should be used only as a memorandum from which the entry is made in the Cash Book. If the cash system has been organized as has been indicated, and a "net cash" column is found on each side of the Cash Book, the use of bank columns may seem unnecessary where only one depository is used. The total in the "Net Cash" column on the receipts side of the Cash Book each day, representing cash receipts for that day, represents, likewise, the deposits for the day, and the total in the "Net Cash" column on the payments side of the Cash Book each day represents the total checks drawn each such day.

Again, the bank columns may be considered as memorandum in character only, which is rare. In such case, all receipts are entered in a "currency" column. When a deposit is made, the amount of the deposit is entered in the "bank" column as a memorandum and is credited to the "currency" column. Checks are entered as usual in a credit "bank" column. The "currency" column, therefore, would show all cash on hand at any time not

deposited, and the difference between the two bank columns would show the bank balance. A Cash Book with bank columns is shown at the end of the preceding section; another form, somewhat similar, is shown below:

CASH BOOK—RECEIPTS SIDE

Date	Accounts Credited	L F	General Ledger	Customers Ledger	Sales Discount	Bank Deposits
			Cr	Cr	Dr	Dr
			1	2	4	3

1+2 = 3+
or
1+2-4 = 3

CASH BOOK—PAYMENTS SIDE

Date	Check No.	Accounts Debited	L F	General Ledger	Creditors Ledger	Purchase Discount	Bank Checks
				Dr	Dr	Cr	Cr
				1	2	4	3

1+2 = 3+4
or
1+2-4 = 3

§ 75. Cash Receipts Register

Thus far, the Cash Book has been discussed as a record kept within the covers of one book. However, conditions are found at times under which the one book record is not desirable; the division of the one record into two or more may render a problem rather easy of solution.

Making use of this idea, the first thing to do is to separate the one Cash Book into two of them, each distinct and separate from the other; one in which to record cash receipts and the other in which to record cash payments. By so doing, no accounting principle has been violated because, as was explained in Volume No. 1, a Cash Book is really two records kept for convenience, in its simple form, under one cover, one for the record of cash receipts and one for the record of cash payments; when under one cover, a page of receipts is followed by a page of payments. Therefore, if under ordinary conditions it is convenient to have the two records under one cover, it might be equally as convenient, under other conditions, to have each record separately bound. When done, the result is:

1. Record of cash receipts, or Cash Receipts Register
2. Record of checks drawn, or Check Register

A Cash Receipts Register would be valuable under the following conditions:

1. Cash receipts are many and cash payments few, or vice versa. In the one Cash Book, cash payments must be set out exactly opposite the receipts,—one page of payments following a page of receipts. Therefore, if the receipts are many, and the payments few, the credit side of the Cash Book will contain considerable waste space. This waste space may be made use of to advantage by cutting the Cash Book into two parts, each in a separate cover—one part for the record of receipts of cash and the other for the record of cash payments by check.

2. A large number of customers may require the use of many Customers Ledgers, each one of which must have a controlling account column on the Cash Book. The number of these columns may be so great as to make the Cash Book, as one book, a heavy, cumbersome record. Such unwieldiness may be eliminated by splitting the single Cash Book into two of them as indicated.

3. One employee may have too much work recording both cash receipts and cash payments. If the one book be cut into two records, two employees may work thereon to advantage without each one being in the other's way.

The conditions which may be cited as making the two-record method of keeping the cash transactions desirable are many. Sometimes, more than one Cash Receipts Register may be used to advantage; one may be used on Monday, Wednesday, and Friday of each week while the other may be operated on Tuesday, Thursday, and Saturday of each week. On Tuesday, for example, the book-

keeper posts the Monday's record to his Ledgers without interference from the cashier who has his Tuesday's register for his exclusive use on that day. Again, one register may be used for two consecutive days, and the other on the next two consecutive days, each alternating with the other. There may be a day register and a night register as in a hospital or hotel office; there may be one register for each department or for each cashier. As said above, the possible variations are many.

It should be borne in mind that since the receipts of cash may come through in many ways,—as through the mails, and over the counters of a number of departments, provision should be made to keep a control over the original receipt of the money. This control may be maintained by means of a cash register, by means of duplicate sales slips,—one copy going to the cashier, or by means of a duplicate receipt,—the original of which is given the person from whom the cash is received. The total receipts each day are proved before entry in the books.

In connection with using this record, deposit tickets should be made in duplicate, the duplicate being retained on file for audit purposes. If the bank will certify each duplicate deposit ticket, an accurate audit of the deposits will be facilitated.

The headings for a Cash Receipts Register are shown below:

Day
Deposits
  Bank A
  Bank B
Net Cash Received
Cash Discounts Allowed
From Whom
Particulars

Accounts Receivable
  A-H
  I-N
  O-Z
General Ledger
  Account No.
  Amount

§ 76. Check Register

The Check Register is developed from the payments side of the Cash Book. It is especially desirable where a number of bank accounts are used, since it sets out in columnar form both the deposits made in each bank account and the checks drawn there against. The result is the showing thereon of the status of each bank account. Because of the fact that an examination of a Check Register should disclose the daily status of each bank account, checks which are fastened to stubs are unnecessary; to this end, where a Check Register is in use, it is customary to find that the checks in use are numbered and put up in pads.

In its use with a Voucher Register, to be described in a later chapter, distributions are not made in detail upon the Check Register, as is done on the regular form of Cash Book in connection with the Purchase Journal. This is because the distributions are confined to the Voucher Register itself. Every payment made is supported by a properly authorized audited voucher, and each check drawn therefor is entered as having been drawn to "vouchers payable," since the distribution has already been made upon the Voucher Register. The voucher number is entered in the Check Register. The latter may, also, contain a column for purchase discounts.

The headings for a Check Register are shown to be as follows:

Day
Deposits
  Bank A
  Bank B
  Total
Checks Drawn
  Check Nos.
  In Favor of
  Amount
    Bank A
    Bank B
    Total
Discounts Received
Accounts Payable (Audited Vouchers)
    Amount
    Voucher No.

§ 77. Cash Recap Sheet

Where a number of Receipts Registers are in use, or a number of Payment (Check) Registers, or both, there should be a record in which the results of each of the above could be brought together in summary form for control purposes. Such a record amounts to a "recap" sheet showing total deposits in each bank, total checks drawn there against, and the resultant balance.

§ 78. Petty Cash Records

The imprest method of recording petty cash transactions was described previously. The method will be elaborated on slightly in the present section. However trivial, every petty payment should be supported by a receipt (or voucher-written authority to make). The total of these receipts or vouchers added to the total cash in the petty cash fund must at all times equal the fixed amount set aside as the petty fund.

When petty cash transactions are numerous, and per-

haps even if not, it may be desired to record them in a book—loose-leaf or bound. Such book would be ruled with as many columns and as many headings as the classification needs demand. Such a record may be manipulated in one of two ways. A loose sheet may be used for each week or month. Upon such sheet the analyzed disbursements are distributed as made. At the end of the period the sheet totals are summarized; the sheet with its accompanying vouchers is handed to the general cashier who after checking up the work, draws a check to reimburse the fund, and who then posts to the Ledger accounts, as shown on the summary sheet, copying the summary entry on his Cash Book, supporting same by reference to the sheet with its accompanying vouchers.

The second way to proceed is to use a bound book, plus the vouchers. But the person in charge of petty cash instead of handing the vouchers to another for posting purposes in the main Cash Book retains them as receipts for the accuracy of his figures, having the Petty Cash Book posted periodically direct therefrom to the Ledger accounts affected. In this latter instance, no special summary voucher need be prepared as the summary appears on the last page of the Petty Cash Book for the period, consisting of the totals of the classified columns. Postings are made direct from these totals; and both detail and summary records are shown in a bound book. It is needless to state that the used vouchers, in either instance, are filed away for audit purposes.

In ruling a Petty Cash Book, the refinement of analysis is the main consideration. A simple two-column Journal ruling is sufficient when only one Expense account and the Petty Cash account are affected. If, on the other hand, the disbursements must be analyzed so that totals may be posted to a number of different Ledger Expense accounts, as many columns will have to be used

as the classification items may require. In this case, the record is a columnar one with its distribution columns all to the right of the explanation space.

The use of petty vouchers is recommended for all cases. Vouchers should be prepared and numbered in advance. And when a voucher is entered in the Petty Cash Book its number should be entered likewise. In

PETTY CASH VOUCHER No. 97

New York, ...19....
Account to be Charged..........................LF......
Total Amount $.............
Details:

....	....	......
....	....	......
....	....	......
....	....	......
....	....	......

Approved: Received Above Amount
....

PETTY CASH SUMMARY VOUCHER

No..............
New York, ...19....

Date	Name	For What	Charge to	Amount	Received by

Approved by:..................................

Date	Totals Dr. Total	Cr. Total	Petty Cash Book Explanation	Distribution Postage	Carfare	Office Expense	Etc.

this way, vouchers may be located by number. The form of a petty voucher need be no larger than 3 by 5 inches.

If hundreds of petty transactions occur daily, it may entail much labor to enter each individual voucher upon the Petty Cash Book. To eliminate such waste, the vouchers may be grouped as made out, each group being added together at the end of the day, and only the total for each group entered in the record.

§ 79. The Cash Journal

The Cash Journal, known as a combination Journal and Cash Book, is a record in which cash entries and all other Journal entries are combined and from which all postings are made to the general and subsidiary Ledgers. Some persons advocate the use of such a record under almost all circumstances, whereas, in fact, its use is decidedly limited to establishments of the smallest type carrying but a limited number of accounts, and who have but one bookkeeper, he perhaps, of limited intelligence only.

A form of ruling for such a record is shown below. The cash record is kept in the two columns to the left of the explanation space. The rest of the bookkeeping record is entered on the right in the columns allotted respectively to the kind of transactions involved. The headings used are common to most business organizations; others may be added as required.

The postings of amounts entered in the accounts receivable, accounts payable, and general ledger columns are made to the respective ledgers in detail. Postings of all other columns together with the postings of the accounts receivable and accounts payable columns are made at the end of the month after the book has been audited and all postings verified. Postings may be verified by extracting the totals of the debit and credit columns;

these, after eliminating the beginning cash balance, should equal each other.

Such a record may be useful in a household system, a professional man's system, and in a small store or factory using few accounts and with only one person to keep them. In general, the disadvantages outweigh the advantages; therefore, no more will be said concerning it.

Cash Journal—Column Headings

Month and Day	Cash			Account and Classification	
	Deposits	Ck.No.	Withdrawals	Debits	Credits

LF	Accounts Receivable		Accounts Payable		General Ledger	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.

Mdse. Allowances		Cash Discounts		Payroll		Freight		Petty Cash	
Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.

General Expense	Office Expense	Office Salary	Etc.

A detail daily summary sheet may be used in connection with this record for entering the totals each day. After the totals of all columns have been transferred to the summary sheet, the debit and credit amounts thereon are footed, and if the two totals are in agreement, it is assumed the work is correct. Totals are posted to the General Ledger from the summary sheet, and the detail to the Accounts Receivable and Accounts Payable Ledgers from the combination Journal.

The columns headed for a summary sheet, as indicated above, would appear about as follows:

Name of Account
Explanation
Folio
Debits
Credits

§ 80. Cash Sales

It is fitting and proper to show an analysis of transactions in a record of original entry, but this analysis should not require that transactions as a group be split for such entry, part in one record and part in another. Purchases and sales may be analyzed by departments or by kinds of commodities. Likewise, cash transactions, receipts and payments may be analyzed to save posting labor.

On the receipts side of the Cash Book, two classes of items outnumber all others—receipts from Cash Sales and receipts from Customers on Account. These two classes may be segregated one from the other each into a special column; the receipts side of the Cash Book would then be columnarized as:

Net Cash "Cash Sales" Accounts Receivable

On the payments side of the Cash Book, the columnarization may be made also, based upon the minuteness of the analysis desired, say, about as follows:

Net Cash "Expenses" Accounts Payable

Cash purchases, when numerous, and any class of frequent expense may be allocated each to a special column.

Theoretically, if the Cash Book were considered by itself without reference to the other records of original entry, no fault could be found in providing a special column thereon in which to hold Cash Sales. When a Cash Sales column is thus used, each cash sale transaction would be entered therein. If a distribution of Cash Sales was desired by departments or by classes of merchandise, many Cash Sales columns would have to be used. If the Sales Book is examined, we notice that it should have the same columnarization for sales as does the Cash Book. The result is a duplication of columns in the Sales Book

with those of the Cash Book. And since Credit Sales are placed in the Sales Book and Cash Sales in the Cash Book, sales transactions are spread through two records. The Cash Book now contains a mass of detail, rulings are duplicated, and the amount of total sales cannot be secured from any one particular original record. Therefore, this method of handling is at fault, very badly at fault.

Practically, the Sales Book should be ruled for the entry of both cash and credit sales. At the end of each day, the Cash Sales are entered in total in the Sales Book and distributed to the proper analyzed columns thereon. Likewise, this same total is then transferred to the Cash Book—to the "Net Cash" column. No posting is made herefrom except as to the Cash account since the ledger Sales account is posted in full from the Sales Book; the L.F. column in the Cash Book would contain a check mark indicative of the fact that no detail accounts are to be charged.

CHAPTER V

PROCEDURES, RECORDS, AND FORMS RELATING TO PURCHASES

PART 1. WORKING ORGANIZATION

§ 81. Purchase Department Organization

Purchase problems relate both to organization and accounting. Such as relate to organization cannot be considered at length in a course of this character. Proper organization is essential in the very beginning; without it, the best possible system of accounts will fall and be relegated, so to speak, to the scrap heap. The best materials must be bought for the lowest price. This cannot be done without a well-rounded out organization. Poor buying means loss of trade to a competitor; and loss of trade necessarily means a reduction in volume of sales, the result of which, in most cases, meaning a loss for the fiscal period.

The purchasing department may be small or large; that is immaterial. The theoretical division of the work will be about the same. One man may have entire charge; all functions center in him. The department may consist of a dozen persons; each one will have one or more of these functions for the success of which he is responsible. Whenever possible, even in a small concern, the purchasing work should be handled by one person at least—a specialist.

The activities centering in a purchasing department may be set out about as follows:

1. Securing, selecting, classifying, and filing information to be used in placing purchase orders. This activity centers around the proper maintenance of a catalogue file, quotation file, source file, and record of past purchases.

2. Determining prices at which goods shall be purchased.

3. Handling systematically the requisitions (requests) that come in from the departments to purchase certain items.

4. Handling, issuing, and following up the purchase orders which are sent to the vendor concerns. This may involve determining what routes the goods shall come in over.

5. Receiving, inspecting, storing, and issuing the material purchased. This involves, also, checking up deliveries to guard against errors and mistakes.

6. Handling, and recording invoices in conjunction with the accounting department.

Based upon the above-mentioned activities, the general routine involved in purchasing some article, in general, may be set out about as follows:

1. Issuance of a properly authorized purchase requisition in duplicate or triplicate, for a definite quantity of whatever it may be which is desired.

2. Sending one or two copies of such requisition through uniform channels to the storekeeper.

3. Checking and approval of such requisition by storekeeper, and if approved the making of an entry in what may be considered a Materials Ordered Register. If approval is refused here, the requisition would be returned from whence it came.

4. Sending of such requisition by storekeeper, after approval, to the purchasing department for checking and approval. It is at this point where the information of various kinds on file should prove itself of value.

5. Securing bids, accepting the bid or placing purchase order. The purchase order would be is-

sued in two, three, four, or more copies as desired, and entry of such issuance would be made in a Purchase Order Register, and in the record of past purchases mentioned above.

6. Following up order to secure prompt shipment.

7. Receiving, inspecting, examining, and testing articles sent by vendor.

8. Receipt of purchase invoice, and entry by purchase department in its Record of Invoices Received.

9. Checking, verifying, vouching, entering, and paying the invoice.

§ 82. Purchase Requisition

A requisition should be issued for every purchase made. This document becomes the basis for starting the purchasing activities into motion. Such requisition is a request that the purchasing department order certain materials. This requisition originates in many places within an organization, usually with a department head. After issuance, it is passed to the storekeeper. This may not be done, but no one is in a better position to know if such requisition should be honored, especially since he knows whether or not the article or articles called for are at present on hand. If they should not be on hand, he must of necessity pass the requisition on to the purchasing department. If a requisition calling for certain goods, a delivery requisition, is handed the storekeeper, and he finds he is unable to fill it, he should have authority to issue a purchase requisition to cover the articles asked for.

Purchase requisitions are handled in numerous ways, and no attempt is made above to state the method presented is the only one; it is typical and illustrates organization procedure. Purchase requisitions cover three general types of cases, and each should be kept in mind:

1. When the minimum amount of a certain article in stores has been reached, the storekeeper will issue a requisition. He would also issue one where a delivery requisition could not be filled either because not a sufficient amount of material is on hand or because he never had that called-for material in stock.

2. When special material is required, a requisition should be issued at the point of discovery. It may be made out on paper of a color different from the regular kind so that the storekeeper will not hold it up unduly by wasting time to see if he has such material on hand.

3. Rush material may be required, and for such a document of a third color may be used so that no delay of any kind will occur.

A purchase requisition should at least be made in duplicate,—more than two copies usually are unnecessary. One copy is kept at the point of issuance, and the second (the original) is sent through the prescribed channels.

The major information a purchase requisition should contain may be set out as below:

1. Quantity of material desired
2. Description of material desired
3. Date of delivery
4. Number of requisition
5. Purpose for which material wanted

After the purchasing department has approved the requisition, notice of such act should be sent back to the point of the requisition's issuance. Such notice may be in the form of one copy of the Purchase Order made out in the purchasing department. When the Purchase Order has been issued, the requisition may be filed away for ready reference.

§ 83. Purchase Order

When the purchase requisition reaches the purchasing department, and has been approved, machinery must be set in motion to place the order properly. Here is the point where all this filed information kept in the department should prove of value in placing the order intelligently and quickly. Requests for quotations may first have to be sent out, if no prices are at present on hand.

When the department has determined with whom the order shall be placed, a purchase order is issued. A purchase order should be issued for every order placed—whether by mail, telephone, telegraph, or orally. Such order is the vendor's written authority for shipping the desired goods. Each order should be checked over carefully before issuance.

Purchase orders vary in content, size, style, and quality of paper. All should be serially numbered, and this number should be placed on all invoices and bills sent by the vendor house. If not so placed thereon, a clerk should mark the number of the purchase order on each invoice and bill received. The original copy should be of good quality paper; duplicates should carry the same number as the original.

Purchase orders may be issued in sets of two, three, or four, or more copies, depending on the size of the company and the accounting requirements. At least two copies should be issued, one (the original) to be sent the vendor and one to be retained on file. The written information on the copies may vary in content from that on the original; this depends upon the purpose for which each copy is desired.

The following variations in the use of sets of purchase orders should be noted. They are typical, but would vary with the size of the establishment, its personnel, and the accounting and statistical requirements:

Two copies:

1. To vendor as authority to ship
2. Kept on file

Three copies:

1. To vendor
2. Kept in unfilled orders file as office record
3. To receiving clerk

Four copies—A:

1. To vendor
2. Kept in permanent file—record of authorized purchases
3. Kept in unfilled orders file
4. To receiving clerk

Four copies—B:

1. To vendor
2. To purchasing department
3. To receiving department
4. To auditing department

Five copies:

1. To vendor

2.)
3.) As for four copies above, A or B
4.)

5. To point of issuance

§ 84. Purchase Order Register

The Purchase Order Register contains a record of each purchase order issued—date, number of order, to whom, amount, purpose, when goods expected, when goods received, etc. All columns are filled out on the register as soon as an order is placed, except the one showing date when goods have been received. This last column is kept empty until the receiving clerk reports receipt of goods, at which time it would be filled out. A glance at the record should show orders placed, orders received, and orders outstanding.

§ 85. Partial Shipments Against an Order

Shipments against a purchase order may not all be made at one time. Therefore, care must be observed to record each one properly as received against the order to which it applies. This is done in a number of ways; on the face of the order if shipments are few, or on either the back of the order or on a separate sheet which is made out as each shipment comes in and which is attached to the purchase order, if the shipments are numerous.

When an order has been filled, the proper steps should be taken to check all invoices, and to make the proper accounting entries required.

§ 86. The Invoice

An invoice is an itemized descriptive statement of a bill of goods which has been bought or sold. The vendor sends an invoice to the purchaser when he sends the goods which the latter has bought. An invoice, to be of value, should contain certain information:

1. Place of sale
2. Date of sale
3. Vendor
4. Vendee
5. Quantities
6. Kinds of goods
7. Terms of sale
8. Manner of shipment
9. Etc.

A purchase invoice should be audited as soon as received, because upon it are based the bookkeeping entries concerned with purchase transactions. Just what form such a verification will take depends upon the organization of the business involved. If the business is small, the procedure may be about as follows:

1. Placed in a temporary file to await arrival of goods
2. Checked against arrived goods as to quantity, quality, and price
3. Extensions and total of invoice verified

4. Invoice entered in Purchase Journal
5. Placed in temporary file until paid
6. Upon payment, invoice drawn from temporary file and filed permanently by name of vendor notation being made thereon in some way that payment has been made. The canceled check may be attached thereto for this purpose

The face of the invoice is usually rubber stamped, the stamp providing substantially the following:

Invoice number ....
Date received ....
Merchandise received ....
Prices O. K. ....
Extensions O. K. ....
Paid by ....

Each line is initialed by the person who handles that phase of the work.

If the business is large, one in which a number of copies of each purchase order are made out, the handling of each purchase invoice becomes more complex, based upon the number of copies of each order prepared in the first instance and their disposition. When goods are received, the auditing procedure may be about as follows:

1. Receiving department copy of the purchase order filled out and sent to auditing department
2. This copy of the purchase order then checked against the copy on file in the auditing department, and against the invoice received from the vendor. The invoice has by this time come in, has been received by the designated employee and has been turned over to the auditing department
3. Invoice extensions and totals verified
4. Invoice entered in purchase record if all is found to be in order as set out in point (2)
5. Invoice placed in temporary file until paid
6. When paid, invoice placed in permanent file, therein being filed according to system in use:

a) By name
b) By invoice number
c) Etc.

§ 87. Invoices for Returned Purchases

Sometimes goods which have been purchased prove to be unsatisfactory, and must be returned. The shipping clerk should keep a record of such returns so that the company will be in a position to secure the correct amount of credit from the seller. The vendor usually will send a returned goods invoice similar to the purchase invoice in form, but of a different color so that it may be distinguished easily from the regular kind; the amount of this invoice is a credit to the purchaser—not a debit. This fact should be made apparent to the purchaser.

§ 88. Invoice Register

An invoice register is useful in a concern in which invoices are sent from one department to another for approval, in order to keep them from being lost during their travels through the establishment. Delay or loss of an invoice at discount time may mean the loss of a large cash discount. Such delay or loss should be avoided.

An invoice register is ruled to show date of receipt of invoice, amount, received by whom, where sent, date sent, when returned.

§ 89. Cash Discounts

After an invoice has been recorded in the invoice register, the discount date should be determined, if a cash discount is allowed for early payment. Such date, when calculated, should be marked in a conspicuous manner upon the invoice so that any one handling it will be sure to return it promptly before the date thus set out.

§ 90. Invoice Filing

Invoices are needed frequently, and care should be observed in filing them away so that they may easily be secured when wanted. In a small business, this filing may be done by using an Invoice Book in which each invoice is pasted and from which postings are made to the Ledger. Such a method, on the whole, is unsatisfactory, because the distribution columns cannot be many without making the record cumbersome to handle; likewise, the cumbersomeness would be increased due to the large number of invoices varying in size. The only advantage in using an Invoice Book is in the fact that invoices when pasted therein cannot be lost.

Part 2. The Purchase Journal

§ 91. Simple Journal with Third Column for Purchases

When a credit purchase transaction takes place, it is necessary to post immediately the portion of the entry relating to the creditor from whom the purchase was made, so that such information will be available when the account is settled. On the other hand, the part of the entry relating to the article purchased need not be posted at once to the Ledger. A monthly entry in connection therewith is sufficient for all recordative purposes. This principle should be borne in mind when constructing a record relating to purchases, so that posting labor may be minimized and so that a division of labor on the bookkeeping record is made possible.

The simplest way in which this principle may be applied, is to add a third column to the simple Journal in which to enter the purchase amounts. The debit to Purchases account will be entered in one of these three columns and the total thereof can be posted in one amount at the end of each desired period—usually monthly.

In case of cash transactions, such a journal development was found to be entirely inadequate, especially when the remaining transactions were numerous:

1. Space was wasted
2. Postings for these other transactions had to be minimized
3. The remaining transactions and the purchase and sales transactions were so numerous that the labor of more than one person was required to keep the entries up to date

The same is practically true in the present instance as regards purchases. Therefore, it is found to be more convenient to use a separate record (Journal) in which to record purchases. Hence, the development of such a separate record, by taking the Purchases column out of the Journal and making out of it a separate Journal record.

§ 92. Separate Purchase Record

Just as cash items were taken from the simple Journal and grouped in the Cash Book, so may all purchase items, we noted above, be removed from the simple Journal in columnar form and be grouped in a separate record, in one or more forms of the Purchase Book. The Purchase Book, therefore, is a development of the Journal, and is a Journal, nothing else, used for recording all debits concerned with purchases.

The advantages accruing from the use of a separate Journal record in connection with recording purchase transactions are similar to those cited in reference to the extracting of cash transactions from the simple Journal to be placed within the covers of a separate journal record, the Cash Book:

1. Such a record relieves the Journal
2. Such a record facilitates posting

3. Such a record shows in one specific place the volume of purchases

§ 93. Simple Form of Purchase Record

In its simplest form, this separate record would be a one-column book, or perhaps a two-columned journal ruled book. The total of the entries therein is posted periodically to the Purchases account, which amount is offset by detail credits to each creditor's account; thus is maintained the equilibrium of the Ledger at all times in this connection, so essentially necessary in double entry account keeping.

The two-column Journal is superior to the one-column record, because in the first column may be placed the details of purchases and the totals of each invoice in the second column. Also, where a number of invoices are received from one creditor, they could all be entered separately in a separate group in such Journal, in the first column, and the total of such group be extended into the second column for posting purposes.

§ 94. Invoice Book

The invoice book for recording purchases is obsolete. It consisted of a large blank book in which the purchase invoices were pasted as received. It was a cumbersome record at best, and entirely unsatisfactory. The invoices are pasted in the book when a report of the merchandise received comes to hand from the storekeeper accompanied by a statement that the quantities agree with those shown on the invoice and that the price and amount as set out on the invoice are correct.

Since the invoices were pasted in as received and approved, no other filing of them for ready reference was possible, and since a large amount of space had to be reserved for pasting in the invoices,—and invoices vary

greatly in width,—a usable invoice book could contain but few distribution columns, at most about three: total, discount, net. Likewise, such a record is not sufficiently flexible. Invoices received from one concern cannot be filed together; the creditor's account or a separate register must be examined first to locate a certain invoice when required.

§ 95. Necessity for Purchases Analysis

When a simple purchase record is used, such as any of those which have been described above, purchases must be summarized from time to time in an organization of any size in order to secure an analysis of the buying acactivities.

The preparation of these summaries, as at the end of each month, is apt to be burdensome, especially if a large number of items of different character require classification. In an organization where it is desirable to note the business activities from day to day, the above analysis procedure is unsatisfactory. To secure such a daily analysis of purchases, a medium for this analysis should be provided, to be put in use as soon as a purchase item is ready for entry.

To this end, the purchase record may be further ruled to provide for two columns, one for material purchases and the other for expenses. However, although such a ruling would provide an anlysis as between material purchases and other purchases, it would rarely be sufficient except under the simplest of circumstances. One does not need to elaborate upon the fact that it would be advantageous to know the cost of the different kinds of material bought and at the same time to have an intelligent daily record of the amounts involved in the incurrence of different kinds of expense. Therefore, since such information cannot be secured from the records thus far de-

scribed, it is necessary to proceed further with the discussion of purchase record rulings.

§ 96. Columnar Journal

With further information desired, as indicated above, more columns may be added to the basic record already described to secure totals for each different kind of purchase and expense, the result being, in regard to title, what is known as a "columnar purchase journal." The following indicated headings show a simple columnar development under which merchandise purchases are recorded by departments and in which the inclusion of expense items is provided for. In any particular case, the number of distribution columns and their purpose depend both upon the classification of accounts in use and the frequency of repetition of similar kinds of entries. Infrequent items should not be allocated to separate columns; they should be placed in the "sundries" column.

- Invoice number
- Date
- Accounts Credited
- L.F.
- Total
- Distribution
  - Merchandise
    - Department A
    - Department B
    - Department C
  - Other
    - Freight Inward
    - General Expenses
    - Sundries
      - Account
      - L.F.
      - Amount

Columnar books for ordinary purposes are on the market. Sometimes, however, it may be preferable to

have a special book prepared to meet special conditions. The basic ruling of every columnar book is similar in that it should provide columns for dates, name of account, description or explanation, ledger folio, total; to the right of the "total" column will be a sufficient number of columns to provide for the desired analysis of the total. Other columns, also, may be made use of in connection with special conditions, as for car numbers (as shown upon railroad freight bills), quantities of materials purchased, and number of purchase order.

When the closing date arrives, all distribution columns on this record should be added, and the total of each column posted to the Ledger, except that of the "sundries" column. In the latter, each debit has been posted therefrom individually. The ledger folio numbers for each total figure may be enclosed in a circle, thus (3), each being placed directly under the total figure to which it applies.

It may be desirable, although not usual, because of the longer time it takes and because of the fact that these separate records are all Journals, to pass a summary entry through the General Journal periodically for the total postings, so that in the latter record, in one place, may be found condensed information concerning the month's or period's transactions; likewise, by so doing, one is able by a glance to make sure the proper accounts have all been debited and credited. For the above example of Purchase Journal, the summary entry would be:

Purchases—Department A
Purchases—Department B
Purchases—Department C
Freight Inward
General Expenses
Sundries (Posted in detail already)
  To—Sundry Creditors (Posted in detail already)

§ 97. Control of the Perpetual Inventory Record (Stock Ledger)

When columns are provided on the Purchase Record for quantities, the office is able to check the receipt of purchases, from the statement supplied at the end of the month by the keeper of the Stock Ledger. If information concerning stock is required monthly, the Purchase Journal may be combined with the Sales Journal Summary. By so doing, information is available as to the quantities of the various kinds of merchandise on hand.

§ 98. Supporting Analysis Record

In certain establishments the analysis of invoices may assume large proportions. If the result of this detailed analysis be entered in a columnar book, the size of the latter may become decidedly cumbersome. To eliminate this difficulty, the Purchase Record proper may be ruled to hold a column for each general classification only, and a supporting analysis thereof be provided in another book.

Assume the following state of affairs in illustration of the above. A mill manufactures four kinds of feed. Likewise, it sells something like seventy-five prepared products, all of which may be classified generally into, say, six general groups. Take the item of coal alone. The varieties handled are nut, egg, bituminous, cannel, and blacksmith. Information is wanted daily as to purchases and sales of each grade of coal, not coal in general. A classification column on the Purchase Record with the general heading of "coal" is not sufficient to provide the detailed information desired. The same is true with each general group title covering the other products. If all these items were provided for in one book, the record would be unwieldy; a second record should be installed to provide for the detail analysis re-

quired, while the regular Purchase Book is left only with the general analysis. To this end, a loose leaf columnar book may be used indexed according to the general columnar headings of the Purchase Book, the columns of which are headed according to the desired detail analysis. The totals shown for the respective sections should agree with the totals posted to the respective Ledger accounts at the end of the month.

After an invoice is received and approved, it is entered in the Purchase Journal both in the total and in the general classification columns; likewise, it is entered in the supporting Analysis Record. At the end of each month the columns of each section in the Analysis Record are totaled and cross-footed in order to verify them with the total of the column of the same general name on the Purchase Record.

This detailed Analysis Record, when kept up from day to day, constitutes a monthly summary of all purchases; it reduces the number of General Ledger accounts by classifying into general groups like items which otherwise must be represented by individual detail accounts on the General Ledger.

§ 99. Voucher Defined

Vouchers and the Voucher Register are discussed in the latter part of the present lecture, but in order to understand thoroughly what a voucher is, it seems desirable to present a definition thereof at this point. Webster's dictionary defines "voucher" as follows:

> "A book, paper or document which serves to vouch the truth of accounts, or to confirm and establish facts of any kind; also, any acquittance or receipt showing the payment of a debt; as, the merchant's books are his vouchers for the correctness of his accounts; notes, bonds, receipts, and other writings, are used as vouchers in proving facts."

A voucher is seen, therefore, to be some written evidence authorizing some person other than the one preparing the document to make a permanent accounting record relative to two or more accounts.

§ 100. Posting a Purchase Journal

At the end of a period of time the total of all the purchases for the period should be posted in one amount to the Purchases account upon the Ledger. Each individual item has been posted already to the credit of the individual accounts in the creditors' ledger. Such individual posting should be done daily to keep all accounts completely up to date. After the daily individual postings are made, the Ledger is not in balance. This matters not, because it is put into balance periodically when the total purchases are debited to the various Purchases accounts kept.

Posting to the Ledger may be done from the invoice itself, by means of a properly prepared voucher, rather than directly from an entry made in the Purchase Journal. The voucher is attached to the invoice or invoices which it covers, after the latter are verified as correct, as authority for making the permanent record in the book of final entry. These vouchers are listed in numerical order by name and amount in a register which may be a plain bound book or an elaborately columned record or Voucher Register. Such record is footed monthly, the total being posted as a credit to an account on the General Ledger "Audited Vouchers" or "Accounts Payable." Analysis column footings are posted to the debit of their respective Ledger accounts. Postings are made from the individual vouchers to the credit of the detail accounts upon the Accounts Payable Ledger.

However, in this connection, one must bear in mind, too, that the number of vouchers received daily may re-

quire a slight alteration of the above plan. When the vouchers are not numerous, the plan above may be used to advantage, but where they are numerous, the direct posting method may prove unsatisfactory and require much needless work. Because of this fact, in a large enterprise, it is customary frequently to use a Summary Journal in connection with the general books by means of which postings may be made directly from the vouchers. To this end, the vouchers are summarized and this summary is entered in the columnar Purchase Journal.

§ 101. Purchases Summary

A daily Purchases Summary may be prepared easily on an adding machine, the record being made on loose sheets, perhaps one sheet or two each month. Such a sheet would be ruled as to show along the left edge the purchase classifications, as desired. The ruling across the top of the sheet, from left to right, provides for the days of the month. Cross addition at the end of each month secures the total purchases of each kind for that period.

§ 102. Returned Purchases: Return and Allowance Register

Returned purchases create a problem requiring solution. When few in number, they may be entered upon the regular Purchase Journal in a different colored ink than the regular purchases, so that at posting time their amounts may be posted properly—be deducted from the black ink figures. When this procedure is followed, only net purchases are posted to the Ledger, no separate Returned Purchases account being carried. When the returns are many, a separate section of the Purchase Journal may be used for them, or a separate Journal. In such case, there would be on the Ledger a separate Re-

turned Purchases account for each department, which of necessity is credited for the returns, the creditors' accounts being debited.

Whenever goods are returned or an allowance is made, a separate form of small size should be filled out. From these slips the charges are entered in the Return and Allowance Register, if same is used. The entries upon this register would be analyzed periodically and posted to the proper Ledger accounts. It should be remembered that when goods are returned, the amount thereof must be credited eventually against the purchases recorded in the Stores Ledger.

After entries have been made in the Allowance Register, these slips may be filed away, and after each month's slips have been entered and analyzed, they may be fastened together and filed away permanently with their "recap" sheet.

The return slip referred to above is made out in duplicate, the original to be sent to the vendor from whom the goods were bought, and the duplicate to become the basis for the entry upon the books of account. The information to be contained upon such slip will be about as follows: Number, date, vendor's invoice number, name and address of vendor, place to contain description of goods returned, O.K. of proper official, folio space for stock ledger account number or name, and folio space for purchase ledger account number or name.

The register used in connection with these slips may be columned about as follows:

No. of Memo
Date
Name of Creditor
Debit—Accounts Payable
Credit
  Department
  Amount

§ 103. Cash Purchases: Two Ways of Handling

When a purchase is made for cash, the simple Journal entry therefor would be as below:

Purchases
  To—Cash

An examination of this entry shows that two records of original entry are involved where subsidiary Journals are used. Since it is a purchase, a record thereof should be made in the Purchase Journal. Likewise, since it relates to a cash transaction, a record of it should be made in the Cash Book. If a complete entry were made in each place, to meet the requirements just specified, a double record of the transaction would be made—one duplicating the other, so to speak. This could not be tolerated since by so doing the purchase record would not display the truth and the cash record, likewise, would be false.

To eliminate such falsity and inflation, and yet to pass the transaction into the two necessary records, the expedient is used of setting up the complete record in each Journal, in the Purchase Journal and in the Cash Book, but when posting time comes the credit to the Cash account from the Purchase Journal is not posted because such credit will reach the Ledger via Cash Book; and the debit to the Purchases account from the Cash Book is not posted, because that already has been posted from the Purchase Journal. This expedient prevents the inflation mentioned above, and still keeps the Ledger in perfect equilibrium; the omitted debit from the Cash Book equals in amount the omitted credit from the Purchase Book. When posting, the omitted postings would be indicated in the folio column of each Journal by a mark √.

A second method of handling the cash purchase assumes that the creditor has an account upon the com-

pany's books. Therefore, whether a transaction is on a cash or credit basis, its record is first passed into the Ledger from the Purchase Journal as if it were a credit transaction:

Purchases
  To—Vendor

And then, if the transaction is a cash transaction, a second entry would be made in the Cash Book immediately which would be as follows, expressed in Journal form:

Vendor
  To—Cash

The posting of these two entries to the Ledger produces the same result as if the entry in the first instance had been:

Purchases
  To—Cash

It may be desirable to carry an account with each and every creditor. To do so permits the ledger record to show the exact volume of business done with each creditor,—credit and cash.

It would be possible to open a "Sundry Creditors" account upon the Ledger instead of separate accounts for each creditor with whom a cash business is done. To this account would be posted the complete entry from the Purchase Journal and the complete entry from the Cash Book. The first method is, perhaps, the more common one.

§ 104. Handling Errors in Favor of and Against House

After all entries have been made for purchases, an error may be discovered either in favor of the house or in favor of the creditor. Such errors require adjustment upon the books. And in this connection a regular form

authorizing such adjustment entry may be desirable, which shall be filled out, be verified, and be used as a basis for making the necessary entries.

If the error is in favor of the house, such form or slip is known as a "debit memo for purchases"; if against the house, the slip is called a "credit memo for purchases." A debit memo carries about the following information:

Date
Creditor's account to be debited
Reason for such debit
Authorization
Department to be credited

On the other hand, a credit memo carries the following information:

Date
Creditor's account to be credited
Reason for such credit
Authorization
Department to be debited

§ 105. Loose Leaf Versus Bound Books

Under certain circumstances a bound Purchase Journal is as satisfactory as a loose leaf form. Where entries are relatively few in number a bound book serves all purposes. Purchase entries in a bound book assume a permanency that cannot be guaranteed in a loose leaf form. The type of book to be used is mostly a matter of personal preference. In every case, whether the book is bound or loose leaf, columnar ruled sheets must be prepared for detailed analysis, usually one sheet being headed each day to hold the detail of that day's invoices. A proof of all the entries may be secured by having the total of the invoices audited by a second person, which is an advisable thing to have done.

Part III. The Voucher System

§ 106. Voucher Register and the Voucher System

When a Purchase Journal is used in which to record purchase transactions, it is necessary to open a Ledger account with each creditor to which account are posted the various debits and credits pertaining thereto. Such an account is decidedly useful at settlement time because in it are displayed the total purchases from such creditor, allowances, returns, balance due, etc. In a small business at least this method of handling creditors' accounts should be followed.

When the number of creditors is large, as may be the case in an organization of considerable size, the handling and keeping of a Ledger account with each creditor may soon be a big and almost impossible task. This would be especially true in a concern buying from a large number of people, with each of whom but little business is done. Under such a condition many of these numerous accounts may hold one or two entries during the course of a year, or other accounting period. As a result, some expedient should be resorted to, which will eliminate the necessity of opening an account with each creditor.

The expedient in this connection is to place upon the General Ledger a summary account to which may be posted in total the payments made to them after a posting of the total payable on account to creditors has been made. The net balance in this account should show at all times the amount due the creditors as a body. Ordinarily, an account of this kind is a control account, yet under the present case we do not expect to make use of a subsidiary Ledger in the true sense of the word. However, the use of such an account must be accompanied by some record scheme whereby may be set out the amount due to each individual creditor.

The deficiency mentioned in the last paragraph, in connection with using a summary account on the General Ledger for creditors is eliminated by using in place of the usual Purchase Journal a record called a Voucher Register, as the record of original entry, in connection with a document called a voucher,—already defined. The Voucher Register is supposed to combine the essential record with the completed transaction, so that reference to more than one book will be unnecessary.

Primarily, the Voucher Register is supposed to take the place of the regular Purchase Journal employed to record, as a rule, the receipt and disposition of invoice values, whereas the voucher is used in place of the Ledger account with a creditor. Although a Voucher Register may be used in connection with other purposes, the entire system being controlled by it, in this course we are concerned with it merely as a substitute for the Purchase Journal.

A voucher establishes the accuracy of the amount owed to a creditor and it may, if ruled so as to contain a receipt form, be a receipt for money paid to such creditor; this combination, however, is not advisable, as will be seen from the discussion in a subsequent section on "filing vouchers."

The voucher system has, as its fundamental object, the elimination of creditors' accounts. From the subsequent discussion it will be noticed that the voucher system may be very satisfactory under certain circumstances and decidedly unsatisfactory under others.

§ 107. Advantages and Disadvantages of Voucher System

The voucher system has many advantages and disadvantages which are important and should be carefully considered in the installation of any system. The chief of these may be found in the following list:

Advantages:

1. Practically no posting required
2. No unauthorized claim can be paid, although payment for a claim may be authorized more than once
3. All details concerning a claim, receiving, distribution, authorization, verification, payment, and acknowledgment of receipt of payment by vendor are recorded and kept upon a very few pieces of paper
4. An audit of the accounts is facilitated and its expense consequently minimized
5. Its use eliminates the preparation of the regular monthly Trial Balance of the Accounts Payable Ledger

Disadvantages:

1. Authorizing, O.K'ing, filing, and recording vouchers is a laborious task and entails considerable expense. A business of moderate size may find it less expensive to use the regular creditors' Ledger
2. The total liability to individual creditor concerns is not shown. To determine this, reference must be made to some other record or all vouchers must be individually examined. This other record might be a card form, a sheet, or a page in a book; such record, to be accurate, must be verified constantly and this requires time, which means—expense. This verification must be secured, because without it an amount shown upon a voucher as being due may be paid twice
3. The keeping of no Ledger accounts may prove to be of great disadvantage when certain information concerning a creditor is desired or needed at a later date
4. Where payments are made "on account" the voucher system is decidedly unsatisfactory

§ 108. Preparation and Handling of Vouchers

The usual form of voucher is a convenient sized blank sheet of paper ruled so as to contain the following detailed information on its back concerning each expenditure:

Business name
Name of creditor
Address of creditor
Date
Voucher number (vouchers are numbered consecutively)
Amount owed
Details of expenditure made
Approval of expenditure by company clerks and officials who have prepared, checked, and approved voucher for payment
What accounts are chargeable
Number of check issued in payment
Etc.

When folded, this blank is reduced in size to 4 x 9 inches. It may, also, contain a receipt form so that when settlement is made with a creditor the latter may sign it as a receipt for payment received for the items set out in the voucher.

Vouchers vary in size and form; they may be made in duplicate, triplicate, quadruplicate, etc., according to the system in use. Their handling in one establishment may vary from the method followed in another. For example, consider the following as illustrative of one method of handling. In one certain establishment, the vouchers are bound together in pad form, and when detached therefrom a printed stub remains. As soon as a purchase is made, a voucher and stub are made out, the voucher containing all necessary details concerning the transaction, unless the transaction is so complicated that all information cannot well be written on the form. The invoice is

fastened to the voucher in either instance. The stub is filled out, summarizing the transaction in such a way that the information it contains is set out so as to be readily available for entry upon the accounting records.

When payment is made, the voucher is sent to the vendor with a request that he receipt and return it. If no return is made, the stub becomes the firm's record of the transaction. All undetached vouchers which are filled out represent unpaid bills. The entries upon the Voucher Register are made from the vouchers, or from the stub if the clerk happens to have forgotten to make the entry from the voucher. At the end of a specified period, weekly, the postings are made from the register to the Ledger. Postings are made from the Cash Book for bills paid, at the same time. The balance in the summary Ledger account "Vouchers Payable" is supposed to agree at all times with the vouchers undetached (unpaid vouchers) in the voucher pad and the unpaid items on the Voucher Register.

Vouchers are usually prepared after invoices have been checked. In such case, they may be referred to as "audited vouchers." Vouchers may be prepared, however, just before payment is made. In the latter instance there would be no unpaid audited vouchers.

§ 109. Form of Voucher Register and Use

The Voucher Register (or Record) is a book of original entry in which all vouchers prepared are entered in numerical order. It may assume the same form as a Purchase Journal except that an extra column is added in which to indicate the voucher number and another extra column in which to indicate the date of payment and check number. No provision, ordinarily, is made for posting individual items to creditors' accounts. The following two forms should be compared:

Purchase Journal

Invoice No.	Date	Creditor	Address	Terms	Due Date	L.F.	Total

Distribution of Debits

Purchases			Freight	Trade Expenses	Sundries		
Dept. A	Dept. B	Dept. C			Account	L.F.	Amount

Voucher Register

Voucher No.	Date	Creditor	Address	Terms	Due Date	Total	Purchase Discount

Distribution of Debits

Purchases			Freight	Trade Expenses	Sundries		
Dept. A	Dept. B	Dept. C			Account	L.F.	Amount

Payment	
Date	Check No.

Comparison of the two forms above shows that the only differences between the Voucher Register and the Purchase Journal are the inclusion in the Voucher Register of a "payment" column and the method of numbering vouchers. As each voucher or invoice is paid, such fact is recorded in the "payment" column.

Postings from a Voucher Register are made periodically, usually monthly, and are similar to the postings from a Purchase Journal except that no postings are made to individual creditors' accounts. A controlling account, or in this instance a summary account, called "Vouchers Payable" or "Audited Vouchers," is carried on the General Ledger to show the total accounts payable. The total of the "Total" column on the register is credited to this account. The total of each distribution column is posted, except that of the "Sundries" column; from here each item must be posted individually to the account named. Postings are made to the General Ledger after the columns on the register have been footed

and cross-footed, and the agreement there between established so that proof is secured of the accuracy of the entries therein made.

On the Cash Book a column is added to the credit side in which would be entered individual payments of vouchers as made. The total of this column would be debited to the General Ledger account of "Vouchers Payable" at the end of each month. As payments are made, record of same is entered daily in the register in the Payment columns, and the voucher number is entered in the Cash Book; this latter takes the place of the usual folio number when an individual creditor's account is carried upon the Ledger. Examine the ruling given in Chapter 4, ante, for the Check Register.

Monthly, at least, all controlling accounts should be proved up against the detail accounts they control. And in proving the Accounts Payable account against the Voucher Record the method is to check the General Ledger account balance against the open items upon the register those items not yet marked off as having been paid. A list of these open items can be run off on the adding machine and if found correct the voucher numbers applicable thereto may be entered on this tape; to all intents and purposes such a prepared list becomes part of the regular Trial Balance.

The Discount column may be omitted from the Voucher Register; if so, it is placed upon the Cash Book. If all discounts are not taken advantage of, no discount column should be placed upon the register. However, if the Discount column is carried upon the Voucher Record and used, and when a certain voucher is paid without taking advantage of the cash discount, the portion of the check issued representing the discount not taken advantage of must be debited to the Purchases Discount account.

Columnar headings for a form which may be used either as a Purchase Journal or as a Voucher Register are shown below:

- Date
- Voucher Record
  - Invoice Date
  - Voucher or Invoice Number
  - Date Paid
  - Paid by Check No.
- Particulars
- Credit
  - Accounts Payable
  - Freight
- Debit
  - General Ledger
    - Account
    - L.F.
    - Amount
  - Distribution
    - Account
    - L.F.
    - Amount

§ 110. Adjustments and Installment Payments Under Voucher System

Creditors' accounts are not always paid in full in cash; discounts, allowances, and adjustments may partially reduce the amount to be paid, and other assets may be taken instead of cash. Under such conditions a special adjustment entry is required—except for cash discount which is recorded in one of two possible ways as shown above. A journal entry, for example, would be as follows:

Vouchers Payable
  To—Account debited in the first instance

The explanation for such entry should be full and complete. Upon the Voucher Register a remark would be

placed opposite the voucher number concerning what had been done, and including the Journal page number. If the Journal does not contain a special column to hold debits to the Accounts Payable account, care must be observed to make sure the General Ledger account will be debited properly.

Vouchers may at times be paid in installments. In such case, each payment with check number and date should be entered upon the register. The unpaid balance is entered in pencil figures in such a way that it will not be omitted when the unpaid amounts are added up at the end of the month. Installment payments, at best, are not handled satisfactorily in connection with a voucher system. If such accounts are few in number, these few can have regular running or current Ledger accounts set up for them which will be used in combination with the voucher system; if they are many, the voucher system should not be use at all.

When a combination of the two systems is made use of, the Voucher Register requires another credit column, to be used for such credits as are to be posted to individual accounts with creditors. This column may be titled "Accounts Payable" or "Creditors' Ledger," or at least some name distinguishing it from the regular Vouchers Payable column. Such title represents a special creditors' controlling account to be introduced upon the General Ledger controlling a special subsidiary Ledger in which the detail accounts with these special creditors appear. Vouchers are used for both kinds of accounts, and these vouchers may be filed as if but one system of handling creditors' accounts were used.

§ 111. Filing Vouchers

The original invoice and other necessary papers of a supporting nature are attached to the voucher before it is

filed away. Vouchers should be filed before payment in a vertical file in numerical order, the file being called the "unpaid vouchers file." When a voucher is missing, its loss will be quickly noticed. When a voucher is taken from the file for any purpose, a piece of paper the size of the voucher containing its number, destination, date, and signature of the person withdrawing it, should be filed in its place. After a voucher has been paid, it should be filed in the "paid vouchers" file.

It is unnecessary to send vouchers to a creditor for receipt when payment is made, since the use of a voucher check is sufficient for this purpose. The voucher check is a combination of voucher and check, its form being similar to the form of a voucher as described already, except that its face represents a check. It was described in Chapter 3. Sending ordinary vouchers out to creditors for receipt means either inevitable loss of many because of the failure of some creditors to return them, or at least often much delay in receiving them back. The voucher check, already described, is sufficient for this purpose.

When vouchers are filed numerically, all vouchers for any one creditor will of necessity be scattered through the file; this may not be desirable when all vouchers for one creditor are to be gathered together quickly. To this end, a card index may be prepared, a card, 3 x 5 inches, for each creditor being made out. This will have entered upon it the number of each voucher as each voucher is entered. When a voucher is paid, its number on the card may be crossed off. This card file is a part of the regular voucher file.

In order not to lose a cash discount, care must be taken to have the vouchers, upon which a discount is allowed, brought promptly to the attention of the person responsible for their prompt payment. To this end, the numbers

of vouchers to be paid on a certain date should be entered upon a tickler file sheet or card before the voucher is filed. This method permits all vouchers to be filed in one place; any other method will require them to be found in more than one place—an undesirable feature.

§ 112. Voucher System in Connection with Accounts Receivable

The voucher system idea is not generally applicable to accounts receivable, although it may be made so under certain circumstances, as where customers pay each bill individually; for example, in an installment house customers' contracts require the payment of fixed installments at stated intervals. To this end, the Sales Journal would be altered by adding a column to record settlements by customers, and the Journal would then be used in the same way as a Voucher Register.

CHAPTER VI

PROCEDURES, RECORDS, AND FORMS RELATING TO SALES

§ 113. Introduction

It was pointed out previously that after a business developed to a certain point, the Journal must be relieved of its volume of entries. To this end, the Cash Book furnished the first relief. Next the purchase transactions, when sufficiently numerous, were taken therefrom and placed in a separate Journal, a Purchase Record. Again, the sales transactions were eliminated and entered in a separate record. Other separate records, as desired, may be introduced as offshoots from the original type of Journal, each one relieving the Journal of a group of similar transactions. This chapter is confined to a discussion of the development of Sales Records and to covering many points of interest connected with sales not already taken up.

§ 114. Bill Versus Invoice

The term "bill" describes a statement of an account or a claim for an amount due,—for merchandise, services, etc. Ordinarily, "bill" is used interchangeably with "invoice," although the latter perhaps more commonly describes a list of incoming merchandise. "Bill" is more comprehensive in meaning than "invoice" since items other than merchandise may be included in it. The term "bill," therefore, is best used when there is included with

the listing of the items a statement or claim of an amount due. However, usage varies in practice.

§ 115. Sales Department Organization

Only through the sales department activities can profit be secured by means of which a business organization as a whole will function properly. Careful buying and low production cost are essential to the success of an enterprise, but the profitable disposal of the product or products handled is necessary for the success and survival of an undertaking over a period of time. Therefore, proper sales records are essentially necessary if the sales management is to function intelligently and efficiently. Not only are proper accounting records necessary to secure successful selling, but the many sales department activities, such as contact with customers, office routine, supervision of salesmen, branches, agencies, and advertising, must be handled expeditiously, intelligently, and successfully; this can only be done through having correct and efficient sales records.

The departmental organization for sales is determined by the sales methods in use to reach the wholesaler, retailer, or consumer, one or more. The organization necessary to handle retail sales is not similar to that required for mail order sales, or for sales made by personal solicitation,—calling upon the trade; and because of this fact, the accounting system used must conform therewith.

§ 116. Sales Orders

In the past, all original sales memoranda were entered in the Day Book. Upon receipt of an order, entry thereof was made therein with all necessary shipping data relating thereto. Likewise, when orders were given to other concerns, entry was made in the Day Book. This primitive mixed method resulted in much inaccuracy and con-

fusion to the bookkeeper, especially where the invoice was made on one date and the shipment was to go out on a later date; it showed him that a more adequate method was needed, one for recording orders that would permit of fewer errors and less resulting difficulties.

The first step in improving the old Day Book was to use a single sheet of paper upon which each order was recorded as received, one order to a sheet. This revision was not found to be entirely satisfactory unless only one person handled the form or was required to refer to it. A subsequent revision to overcome this defect provided for making two or more copies of each order.

Sales orders should be recorded upon uniform blanks, whether the sales transactions originate by having salesmen or customers send the orders in, or by having these persons bring them in. The number of copies required depends upon circumstances; usually two or more are needed, and only infrequently will one be sufficient.

As soon as a one-copy sales order is prepared, it may be filed as an "unshipped order." Later, when shipment is to be made, the form is removed from this file for such purpose; and when the shipment has been made, it is conspicuously marked in some way as by a rubber stamp. The marked copy, after entry has been made in the books of account, and after the invoice has been prepared therefrom, is then filed in an "orders shipped" file. The current file for shipped orders should contain each month's activity. At the end of each month, the month's orders would be taken from the current file, be stapled together, and be filed away permanently. Again, this one-copy form might first be placed in the "unshipped orders" file. After shipment was made, it could be transferred to a file "orders shipped not invoiced." At the end of each day, the orders in this latter file could be turned over to the invoice clerk for making out the cus-

tomers' invoices therefrom. Subsequently, the forms would be turned over to the bookkeeper for entry in the accounts.

Where two persons require access to the order form, two copies at least should be made; for example, the shipping clerk might be some one other than the bookkeeper. When the merchandise was to be shipped, the duplicate would be sent to the shipping clerk, who, after shipment would return it to the office of the bookkeeper. The latter would compare and check it with his copy, after which it would be his authority for making entry in the customer's account.

If three persons each require a copy of the sales order, two copies could be disposed of as indicated already, and the third could be sent the customer as a verification of the order placed. Again, the third copy, after the shipping clerk has returned his copy to the office following shipment and after such copy has been compared with the office copy previous to entry, might be sent to the stock clerk for entry in the stock record. Again, all copies may be turned over to a clerk who files one and sends the others to the shipping department. The packing clerk, after noting thereon any changes in quantity shipped, returns one copy to the office for final filing. The other is retained in the shipping department for its files.

If a salesman sends in the order, a minimum of three copies should be used,—one for the office, one for the customer, and one for the salesman securing the order. Again, in this connection, four copies might be advisable,—the first three being used as indicated in the last paragraph, and the fourth being sent to the salesman.

The variations in the above are many, dependent entirely upon the conditions of the case under review. For example, take the case of a branch enterprise of a certain type. When a salesman takes an order, he sends the

original thereof to the home office. The next copy he sends to the branch office with which he is connected. The third he keeps for his own information, and the last one he leaves with the customer. The copy sent to the branch office might be handled as has already been described for handling a one-copy order. When shipment has been made, both the home office and the salesman are notified thereof by the branch office. Upon receipt of this notification, the home office secures the information necessary for compiling the statement sent to the salesman at stated intervals informing him of orders shipped credited to his account and the commission earned thereon. The home office, also, might send the branch a copy of the invoice mailed the customer for filing at the branch and for compiling branch statistics.

Each set of such forms should be numbered, numerically preferred. Ten thousand or a hundred thousand numbers, from one up, might compose each separate series. The first series might be prefixed by the letter A, as A1 to A100,000. When the first series is used up, the second would be prefixed by the letter B, and so on. Each duplicate form would carry the same number as its original.

As the sales orders are received or made out by the office, entry thereof should be made upon a loose leaf form of Sales Register, a temporary record whose purpose is to prevent forgetting or mislaying an order after receipt. This record provides for the entry of the number of the order, the date the order was received, who from, and its amount. Since each order is given a number, this number is entered upon the resigter so that the two, the order and the entry, may be connected easily one with the other.

After entry upon the Sales Register, the order should next be sent to the credit department for approval, unless

cash accompanies it. In the latter event, the credit department is not interested, and as a result the order is passed on from the point of receipt to the department in charge of order interpretation,—the order department. After the interpretation markings are indicated upon the order, it may next be handed to the employee charged with making out the requisite number of copies thereof, as a preliminary to its being filled, all such copies being made at one machine writing to save time and to secure accuracy as between the copies. When these copies have been made out, they should be checked against the original order to make sure all items have been entered correctly thereon; then the copies are distributed as desired.

Next, the billing clerk would enter the proper amounts upon the invoice and the posting (sales) ticket. The invoice is sent the customer and the posting ticket is turned over to the bookkeeper. Sometimes, the posting is made directly from the invoice. The record of each day's billings may be kept by the billing clerk so that at the end of each day the total may be given the chief bookkeeper for checking purposes.

From the posting ticket the bookkeeping entries are made. These tickets by themselves, sorted in numerical order and held together in temporary binders, may form the Sales Book. Again, they may be entered individually (transferred) in a Sales Book, the total of which when posted to the Sales account in the General Ledger gives a record of sales and a figure for the Accounts Receivable Control account, carried on the General Ledger. Individual postings are made from the tickets to the customers' accounts in the Customers' Ledger; perhaps the tickets themselves may be sorted by customers and be considered as the Ledger account for each, being filed in folders, one folder to a customer. The procedure is immaterial, from an accounting viewpoint, so long as the

proper accounts involved are debited and credited expeditiously.

§ 117. Sales Tickets

The sales ticket or the invoice is the basis for entry of each sale upon the Sales Journal. Therefore, the information each such posting medium contains should be compatible with the analysis desired so as to facilitate its securement. The basic sales classification will determine the different colors of these sales tickets; for example, if C.O.D. sales tickets are red in color, and those of charge sales white, ease and readiness are provided in sorting the tickets for any one day's work as a preliminary to making the classified record in the Sales Book.

In a business of any considerable size, only each day's total of each class of sales would be entered in the Sales Book. Each class total is secured by grouping first the sales for the day into the classes as kept upon the accounting records. In addition, each ticket is used as a posting medium for posting the sales charges to the customers' accounts.

When the books of account have absorbed the information as set out on the sales tickets, the latter may be filed away in bundles for future reference.

§ 118. Simple Journal as a Sales Book

With a general idea of the office sales procedure in mind, from the time a sales order is received until the posting ticket is passed to the bookkeeper for entry in the accounts, it is necessary next to consider the recording of sales in the books of account, basing this record upon the written evidence that a sale has been legally consummated.

It has been shown already that a special column may be introduced upon the simple two-column Journal in

which to collect the purchases during an accounting period, from which temporary repository the individual postings would be made immediately to the creditors' accounts, and the total, at the end of each month, to the Purchases account and to the Creditors' Control account on the General Ledger. Similarly, an extra column might be introduced upon the simple two-column Journal in which to record sales items. However, except in the smallest of concerns, this expedient soon proves inadequate; the need of relieving the Journal of its many entries will be so pronounced that a change in this simple columnar development will be required. As in the case of purchases, the first step in this new direction will be to take out the extra third column from the Journal and make of it a separate Journal in which to record only the sales transactions. For a small concern, not requiring sales to be recorded by classes, this may prove entirely adequate. Thus, we have the simple form of Sales Book as a separate record introduced into the accounting system.

§ 119. Separate Simple Sales Record

In the last section it was noticed that the simplest form of separate record in which to record sales in appearance is that of a simple two-column Journal. In this connection, for illustration, consider the Sales Book as used, say, in a cloak and suit house selling goods wholesale; its form in such an establishment usually is very simple. The record may be either bound or loose leaf. The pages are in duplicate. The original (white in color) is divided by perforations into three parts, each part being a sales invoice. These invoices are numbered numerically, three invoices being a page. The duplicate page is the Sales Book; it is ruled like a simple Journal.

A sheet of carbon paper is inserted between the two

leaves. An invoice is written. This is torn out and sent to the customer. The carbon copy remains on the duplicate sheet, the posting being made therefrom to the customer's account. At the end of the month, the total of all sales as recorded on the duplicate sheets is secured and is posted to the credit of the Sales account and to the debit of the Accounts Receivable Control account, both on the General Ledger.

§ 120. Columnar Principle Applied to Sales

A merchant may sell only one kind of an article. Such activity gives rise to numerous debits to customers but only one credit, that to the Sales account. Under such a condition, the separate simple Sales Record may be all sufficient. If, however, this person expands his business and sells a half dozen different kinds of articles, he may wish to analyze his sales into six corresponding classes. To this end, columns are added to the Sales Record,—one for each class of sales, and into these the sales items are distributed.

In this expansion, the original column, to hold the total of sales, should be retained, and each sale first be entered therein. Next, such amount should be distributed therefrom into the correct distribution column or columns. When done, the items in the "total" amount column on any page or group of pages should equal the total of the items in the other columns. This method of tabular proof is a valuable one to use whenever possible since it is one of the principal advantages of columnar records.

§ 121. Sales Classifications

Goods are purchased for sales purposes. Most organizations at the present time handle a number of commodities, with a variety of kinds, qualities, and grades. For sales work a selling organization is necessary. Such an

organization, to be profitable, must have the means at its disposal for comparing the profitableness of one line of goods with another, one sub-department or branch with another, one territory with another, and perhaps even one salesman with another. The aggregate result may be profitable, but without a sales classification along one or more of the lines indicated, it may not be an easy matter to ascertain whether the profitableness is as great as it should be. Such a requirement makes it necessary to classify sales, and this in turn necessitates classifying the purchases in a similar manner.

If profit is not as great as it should be, the reason may be within or without the control of the management. If within its control, a proper classification along the above lines enables the management to apply the needed remedies; if without, a classified record will determine whether or not a given line, branch, department, or territory should be continued or dropped.

The basis of any classification depends upon the business and the nature of the goods sold. Classification may be in a number of ways: a general or detailed grouping by classes, a grouping which will indicate sales of own manufactured commodities as well as those of goods purchased for sales purposes, or groupings to segregate sales as to cash sales, credit sales, branch sales, installment sales, consignment sales, approval sales, etc.

When the ledger classification of sales has been determined upon, the grouping into classes will proceed from left to right and chronologically from top to bottom, on each page of the Sales Record. This principle has been indicated previously.

§ 122. Sales Analysis Records

Ordinarily, the classification of sales will not be very extensive. In such event, the entire classification may be

included upon the Sales Record. In case the classification is extensive, a Sales Analysis record may be used in which to record the necessary distribution of sales. The same original data, the sales slips, duplicate bills, etc.,—used for making entry in the Customers' and Cash Records would be used for making entry in the Analysis Record. The information herein recorded is not posted, but merely used when statements are prepared.

The entries upon such Analysis Record may be made for each sale consummated, or the sales for each day may be grouped prior to entry and group totals, rather than each individual sale amount, be entered upon the record. This latter procedure would be followed where the sales classification is extensive, and where only a few classifications are affected by each entry upon the Analysis Record. Such procedure avoids loss of paper space and a scattered appearing result.

§ 123. Purchases Analysis Conforms to Sales Analysis

The classification used for sales should be followed as to returned sales, purchases, returned purchases, and inventories. Only by so doing is it possible to determine the gross profit from the different kinds of merchandise handled.

And in this connection, such charges as infreight, duty, insurance, and handling charges on goods coming in, should be classified in a similar manner, so that the cost of each group of sales may be determined. However, certain of these analyses may not be made in the first instance because of practical difficulties. At the end of each period, a distribution of certain of these charges is made upon a more or less arbitrary basis. This means that first such charges are accumulated in a group account, as, say, "Infreight," and that at the close of each period, the amount of infreight is spread over each class

of purchases. The following entry in this connection is illustrative:

> Purchases—Class A Goods ....$¢
> Purchases—Class B Goods ....$¢
> To—Infreight ....$¢
> To record application of infreight charges against purchases

§ 124. Relation of Sales to Accounts and Notes Receivable and Cash

Goods are sold either for cash or on credit. If on credit, the operation requires the recording of the customers' obligations, the Accounts Receivable. Accounts Receivable may be canceled by the customers giving notes therefor; this gives rise to the need for accounts in which to record the Notes Receivable. Finally, when the notes are paid, cash is secured. The ultimate realization from all sales is cash. Therefore, it may be stated that Sales Records are correlated with Accounts Receivable, Notes Receivable, and Cash. And as a result of this cycle, a proper accounting system must provide for the interlocking of these various factors.

§ 125. Controlling Accounts Receivable

Accounts Receivable and Payable have been discussed thoroughly already, but as concerns the Accounts Receivable there is a certain relationship between them and the Sales Record which must be observed. If the Accounts Receivable are numerous, the Ledger record thereof requires subdivision. This may be upon any basis best suited to the needs of the concern under scrutiny, as alphabetically, geographically, etc. Over the Accounts Receivable one or more controlling accounts may be established, one for each Accounts Receivable Ledger. If a number of such ledgers are used, the Sales Records

should be columnarized to correspond to each such Ledger; in this way the securing of the proper control is facilitated. Where only one Sales Book is used, it would contain columns corresponding to the number of Customers' Ledgers. Where more than one Sales Book is used, there may be one such book for each Customers' Ledger.

§ 126. Notes Receivable Records

Notes Receivable may be received in the first instance as the result of a sale or they may be received in settlement of Accounts Receivable. If such notes are taken infrequently, no special treatment is required in the accounts. The Journal is used for their first entry, and from there postings are made to the debit of the Ledger account of Notes Receivable, and to the credit of both the Accounts Receivable Control account and the individual customers' accounts. In this connection, it may be advisable, when a note is paid, to make the credit posting in the Notes Receivable account on the same line as holds the debit entry covering the same note.

The number of Notes Receivable handled may be numerous where the majority of the transactions are on the account receivable basis. In such event, a Notes Receivable Register could be used as the original record, postings being made herefrom to the Ledger account of Notes Receivable. Again, most of the credit transactions may be on a notes receivable basis, many notes being received from the same person covering one sale, as where a machine is sold on the installment plan, one note being received for each installment, and each one falling due in turn when each installment falls due. In such case, there should be a note account on the Ledger with each such customer controlled by means of the Sales Record, each such Ledger account containing details concerning

the notes received and their subsequent payment. With this development in mind, the Sales Record may be columnarized along the following lines:

1. Accounts receivable columns in which to record sales on open account, one such column for each control account
2. Cash sales column in which to record cash sales
3. Notes receivable column in which to record sales on a notes receivable basis. In this connection a separate detail ledger may be used controlled by an account upon the general ledger

§ 127. Cash Sales

If all sales are for cash, the classification therefor may well be found in the cash records. Ordinarily, however, such is not the case, and provision must be made for recording them in connection with credit sales. Even in this latter event, where no analysis of cash sales is required, they are sometimes recorded in the Cash Book in the first instance; this is frequently met with in practice. The column total is posted to the credit of Sales in the Ledger. Under this procedure, cash sales need not be entered in the Sales Book.

However, it is usually poor practice to credit the Sales account through the Cash Book for cash sales. Cash sales should be entered in both the Cash Book and the Sales Book, so that the summaries of each of these two records will show true totals. All sales should be passed through the Sales Book, as a matter of convenience, the charge sales being entered in a column headed "Accounts Receivable," and the cash sales in a column headed "Cash Sales." Further classification may be resorted to as desired. The Sales account would then be credited with the total sales from the Sales Book. Since it is the purpose of the Sales Book to reveal at any time the volume of the sales, it is necessary that cash sales appear therein.

If credit sales are classified in the Sales Book, there seems good reason for classifying cash sales therein also, the daily totals therefor being entered in a lump sum upon the Cash Book. If analysis columns are provided on the Cash Book for cash sales and the same set of columns are used on the Sales Book, for the credit sales, it is not difficult to see that there exists a duplication of rulings, entirely unnecessary under any conditions.

The cash sales may be entered upon the Sales Book daily in detail or in total; if they are numerous, they will be entered thereon in total, one amount for each classification. The amount of cash sales is transferred from the Sales Book to the receipt side of the Cash Book (General column) so that the Cash account will be debited for their amount. The account of Sales seemingly to be credited from the Cash Book is ticked off (√) so that no credit posting will be made therefrom. Likewise, on the Sales Book, the Cash account seemingly to be debited is ticked off (√) so that no debit posting will be made therefrom.

Sometimes, each customer buying for cash is debited from the Sales Book as if the sale were one on credit, and then immediately is credited from the Cash Book. Such procedure cannot well be criticized if cash sales are made to customers who ordinarily purchase on credit, because by so doing their accounts will show the total volume of business done with them. This may be an important factor in the extension of credit to them at a later date. However, unless such a condition is encountered, the opening of Ledger accounts with cash customers is useless and should not be done.

Again, cash sales may be recorded in a separate Sales Book, the Cash Sales Book. In appearance, this record resembles the regular sales record for credit sales. At the end of the day, the totals are transferred to the reg-

ular Sales Book and the total cash receipts from such cash sales are entered upon the Cash Book.

What has been said thus far concerning cash sales refers more to a retail organization than to any other. A wholesale concern usually will have no use for a cash sales record, because cash sales in a large organization, under ordinary conditions, means that from five to ten days are allowed for payment. Therefore, in such a concern, even for a short period of time, the sale is considered as one for credit, and is charged to the account of the customer.

A duplicate receipt should be used in connection with cash sales. The original is given to the customer and the duplicate is used for making the book record. These duplicates may carry classifications to conform to the regular sales classifications; in such event they would be sorted prior to making the book entries therefrom.

§ 128. Sales to Proprietor

The proprietor often takes merchandise from stock for his own use. Care should be observed in accounting for such merchandise in order that the trading results will be correctly stated. No difficulty is met with in posting the charge since it will be made to the proprietor's Personal account. The problem here is to dispose of the credit posting correctly. The cost of such merchandise has been included in the purchases, and unless credit is given properly to the concern or to a certain department for what has been withdrawn, the organization's gross profit will be understated.

Sales to the proprietor should be billed in the regular way, he being charged with the selling price of the merchandise. If, however, he insists on being charged with the cost price, the withdrawal may be recorded as a returned purchase. This would be true when of frequent occurrence, because if credited to the Sales account at

cost the gross profit will be incorrect. When goods are sold at cost, there is no element of profit in the transaction as there is in other sales. However, when withdrawals are infrequent and sales numerous and large, the practical way is to enter the withdrawal in the regular Sales Book; the effect of such infrequent withdrawals upon the gross profit is negligible and the total sales figure will not be beclouded as a basis for estimating profit percentages.

§ 129. Sundry Sales

The Sales Record may be designed with a special column in which to enter sales of any articles which cannot be classified readily under the regular classification headings used for sales. Any sale, of whatever nature it may be, can be recorded, as a rule, most conveniently in the Sales Book; this is the logical medium from which to post the sale to the debit of the buyer. Sales of items other than trading goods should not be credited to the regular sales accounts, because the latter should be used only to show the regular trading sales. The credit for each sundry sale, if concerned with a fixed asset, should be made at cost to the account which records the asset item sold, and the profit or loss involved should be posted to a special account correctly earmarked.

§ 130. Returned Sales

Sales returns may occur either regularly or only occasionally. If infrequent, they present no problem of importance. If regular, they demand strict and careful attention. Returned goods may be divided into two kinds: those which may be resold readily without loss of selling value, and those which have lost a considerable part of their sales worth. In the latter event, the returns should be kept at a minimum, and this means that con-

stant supervision and attention must be given them. To this end, for intelligent deduction and elimination of cause, sales returns are classified in the same manner as are the sales; this would be true, also, with sales allowances and with sales rebates. (Sales rebates are perhaps forbidden by law.)

§ 131. Sales Allowances

If sales returns are infrequent, they may be entered in the Sales Book in red ink. If a cash sale be returned, the Cash Sales column in the Sales Book will contain the red ink entry, and the cash returned will be entered in the Cash Book as a debit to the Cash Sales account.

If the sales returns are numerous, a separate Journal should be used in which to record them, or a separate section of the Sales Book may be set aside for their use. Under any condition, the General Journal does not lend itself properly to becoming an analyzed record of sales returns, sales allowances, and sales rebates.

What has been stated concerning sales returns should be borne in mind in the case of sales allowances, except where the allowances do not occur in the ordinary run of the business. Allowances out of the ordinary for goods damaged on account of contingencies should be recorded by themselves if they amount to any considerable sum, because by not so doing, the percentage of profit on the goods sold will be disturbed. When the above condition is not encountered, they may be merged indiscriminately with sales returns and be handled through the same record.

§ 132. C.O.D. Sales

A C.O.D. sale must be delivered before the cash is received. Therefore, it should not be considered in the same light as a regular sale. Frequently, they are made

to out of town points and a considerable length of time elapses between the shipment of goods and the receipt of the money to be collected. Also, drivers of delivery wagons, when delivering C.O.D. packages, may not turn in the proceeds received until the next day. Therefore, in order that they may not be overlooked, a separate means of booking them should be provided. The simplest way would be to record the credit in the usual manner and post the debit to a C.O.D. account. The balance in this C.O.D. account is reduced from time to time as the cash collected is reported.

When numerous, a column for C.O.D. sales may be provided upon the Sales Book, and one upon the Cash Book in which to enter the collections. A Ledger account for C.O.D. sales should be carried because a few will always be outstanding and uncollected. The Ledger account is debited from the Sales Book and credited from the Cash Book. The balance will be a debit, representing shipments outstanding and uncollected. When infrequent in number, the Ledger account may show each shipment and collection in detail, the credit being entered on the same line as the debit. The open items on the credit side will represent outstanding shipments. When numerous, the postings to the Ledger account should be in monthly totals, a memorandum book being used in which to record the detail of shipments and collections.

When C.O.D. deliveries are local, the packages are charged to the various delivery men upon a route sheet, when taken from the shipping department, and these men are credited with the collections turned in by them, and with any undelivered packages returned. The original sales slip is pasted upon a manila card which has C.O.D. printed in large red letters across the top. This precaution prevents the delivery men from delivering such packages without making collections; each man must account

either for the cash or for the package. This card contains a cash voucher which the driver removes when cash is collected. He turns this voucher in with the cash at the end of his run. The cash, plus the vouchers, plus the returned packages undelivered or refused, form the basis for giving each driver credit upon his route sheet. In connection with a route sheet a route ledger may be used in which each driver is given an account. The merchandise returned is placed back in stock. This method of handling contemplates that the balance of the C.O.D. account upon the books must at all times be represented by undelivered goods in the shipping department.

Another method of handling C.O.D. sales is as follows: The sale is handled just like a regular sale, except that the C.O.D. ticket is made out in duplicate. The tickets are signed by the driver or messenger who takes the package. One signed ticket is held by the store and is treated as cash. When the actual cash is turned in, the driver or messenger is given the ticket covering the same. These he may destroy if he so desires. If certain goods are returned, the ticket therefor is taken out only when a refund voucher is issued to take its place. The C.O.D. sale is rung up as a regular cash sale. No other record than the signed ticket is necessary.

Under any and every condition, the point to remember is that at the end of each accounting period care must be observed to make sure that the statements are not inflated by C.O.D. sales for which cash has not been received.

§ 133. Uncompleted Sales (Contracts): Installment Contracts

A sale may take place for goods not in existence as at the time the sale is consummated; as for example, in the case of building contracts or where goods are to be manufactured to order. Again, the sales agreement may pro-

vide that goods are to be delivered in installments, the purchaser agreeing to take a certain quantity from time to time; such goods may or may not be in existence when the sale is made.

The question arises as to when a sale has taken place under those conditions, so that the proper sales record thereof may be made. If an order for goods not yet manufactured be treated as a sale at the time the order is received, profit is anticipated; and in good accounting, the anticipation of a profit should be avoided. If goods are delivered in installments, to the extent that the purchaser is accountable for goods delivered to him, a sale has fully taken place. Profit may be taken on a building contract to the extent of the part completed; that is, to the extent to which the purchaser is liable for payment under a partial payment plan, or to the extent to which the purchaser has actually made payment.

Suppose a merchant sells goods upon the installment plan. Let us see how this activity may be handled. An account with "Installment Contracts" may be opened, which would be debited monthly with the total amount of contracts closed. The offsetting credit would be to an account of Installment Sales. An installment sale should be entered upon the books only after the first payment thereon has been made. The account of Installment Contracts would be credited with such items as goods returned by installment customers, allowances made to them, the total cash received on account of such contracts, and the balances of such contracts which have been canceled. Such an account is a questionable asset account, representing at the end of each month the total amount due on installment contracts outstanding and in force. This balance should equal in amount the sum of the balances of the installment contracts in force. The installment contracts at times are carried in a separate

Ledger controlled on the General Ledger by the account as indicated.

An installment sale is not a regular sale in any sense of the word, because the probability always exists that the goods may be returned by the buyer due to his non-payment of the installments. When a forfeiture takes place, the profit on the transaction is materially affected thereby. Therefore, the chief accounting question involved in installment sales handled as above, is to make an estimate for loss from uncollectible accounts; the accounts must be kept so as to facilitate the securement of this item.

It is possible, although not good accounting, to handle installment sales practically the same as other sales. In the first instance, they may be charged to the customers and be credited to the various sales accounts. When goods are returned because of forfeiture the Returned Sales account could be debited and the customer credited for the installments still unpaid. The amount of profit or loss resulting from the transaction will show up in the ordinary way in the Profit and Loss account at the close of each period when the inventory is taken and the returned goods revalued. Should the customer fail in his installment payments and not return any goods, the resulting loss would be handled as a bad debt.

When regular sales are made as well as installment sales, the resulting Accounts Receivable should be carefully separated, one class from the other. An Installment Accounts Receivable Ledger would be used and be controlled on the General Ledger by a controlling account. The original records should be columnarized to cumulate the required total figures for this account.

At the end of each period, before closing, the estimated loss on installment accounts should be computed, and the amount of the loss set out separately in the Profit and

Loss Statement. This means that the entire credit to the account of Installment Sales does not represent revenue. Such would be true even though one assumes all the installment accounts receivable to be good; a certain amount of expense will be entailed in collecting the open accounts and this amount should be charged against the profits thus far made. The estimated loss should be liberal, running at times as high as 30 per cent. Again, it may be desirable at the end of any one year to carry over into the following year a portion of the credit to Installment Sales equal in amount to the unpaid balance due from the installment customers; this means that no year takes profit on installment sales except on the actual cash payments received during the year.

The following entries illustrate the correct handling of installment sales:

When a sale has been made: through the Sales Book

Dr. Installment Contracts........$¢
  Cr. Installment Contracts.........$¢

When an installment has been paid by the customer:

Dr. Cash.........................$¢
  Cr. Installment Contracts ....$¢
Dr. Installment Sales............$¢
  Cr. Sales ....$¢

The second entry transfers the actual sale made to the Sales account

At the close of each year, pass adjusting entry through Journal:

Dr. Sales ....$¢
  Cr. Purchases ....$¢
    Profit and Loss..............$¢

This entry permits the Profit and Loss account to contain its proportionate share of installment sales for the year

§ 134. Sales for Future Delivery

Sales for future delivery were briefly mentioned above but not discussed. A sale should never be recorded until delivery is made. One for future delivery may never materialize, because either the vendor or vendee may desire to cancel the contract. So far as the seller is concerned, even though he may bring action against the purchaser for breach of contract should the latter attempt to cancel before delivery, it is usually to his advantage not to do so in order not to lose future trade.

If the order is received in one fiscal period and the sale recorded in the next when goods are delivered, the records may be somewhat at fault, because perhaps most of the expenses of making the sale were charged against the period in which the order was received and not against the one in which the sale was booked. This state of affairs loads one period at the expense of the next and, therefore, an adjustment should be made by means of which the selling expense incurred during the period in which the order was secured will be deferred to the period in which the sale is credited. This procedure should be followed in all cases, and if at inventory time, certain goods are on hand set aside for future delivery, such goods should be included at cost as part of the inventory, with the expense as indicated above, deferred.

§ 135. Approval Sales

Sales on approval are similar to consignments,—not being regular sales, and should never be included in the regular Sales account. Oftentimes they are made use of to inflate the amount of sales made. Approval sales are common in department stores. Goods sent out on approval should be charged temporarily to a memorandum account and, after a reasonable amount of time,—which should always be clearly stated to the customer at the

time of purchase,—the amount of the sale should be transferred to the regular account of the customer.

When an approval sale takes place, the following entry may be made:

Dr. Goods Out on Approval.........$¢
  Cr. Approval Sales.................$¢

Since the two accounts offset each other, they may be omitted from the Balance Sheet. Since the goods out on approval are part of the stock on hand belonging to the concern, they should be included in the inventory; upon the Balance Sheet they may be included thereunder, being set out by means of a separate heading.

§ 136. Consignment Sales

Consignment accounts come into existence when one person sends goods to another for sale; they will be treated in detail later in a separate article. At present, it is only necessary to remark that they should be recorded separately from the regular sales. Since this other person (the consignee) has not purchased the goods, no sale has taken place; no Account Receivable in the accepted meaning of the term is created. Title to the consigned goods does not pass at the time the goods are sent out to the consignee. No profit accrues to the sender until an actual sale occurs. Until that time, the goods belong to the sender (the consigner).

§ 137. Branch Sales

Sales to branches are handled in varying ways:

1. Billed to branch office at cost
2. Billed to branch office at selling price
3. Billed to branch office at a fictitious price

The first method is the correct one to follow, but sometimes not desirable if the home office wishes to keep the

branches ignorant of cost prices. When the latter condition exists, it is usual to bill sales at sales price. By so doing, the home office books record the goods sent the branches as if an actual sale had taken place when in reality such is not the case, the goods being merely transferred to the branch. When sales are billed at sales price, the home office books show a profit not yet realized, and as a result at the end of each period it is necessary to make an adjustment entry relative to all goods at the branches unsold as at the end of the period in question. The value must be reduced to inventory value. At the opening of the new period, whatever entry was made to secure this result may be reversed and the original figures given effect again for use during the new period. Likewise, when a fictitious price is used, the proper adjustment must be made periodically, for reasons similar to those above stated.

Branch sales at all times, on any basis, should be credited to accounts separate from the regular sales accounts. To this end, either a separate branch Sales Book should be used, as where such sales are frequent, or a separate column or columns therefor should be introduced upon the regular Sales Book, as where sales are not frequent.

Transportation charges to branches are usually charged to the current period, and usually are not to be considered in determining the inventory value of goods on hand at the branches. But where the item assumes large proportions, as when the distances from the home office to the branches are great, it is proper to consider such charges as enhancing the value of the stock. However, care should be observed to see that only such charges as actually increase the inventory values are included. The cost of transferring stock from one branch to another should not be considered, unless it would cost

as much, if not more, to ship goods to the second branch direct from the home office than their transfer cost would be, including the transportation charges.

§ 138. Coupon Sales

Certain enterprises like restaurants, and street railways, and certain mercantile concerns, sometimes sell coupon books. The sales price thereof is frequently a less amount than the redeemable worth of the coupons. When sold, the Sales account should not be credited, and still the transaction requires entry upon the books of account.

The correct procedure to adopt may be set out as follows:

When sold:
Dr. Cash ....$¢
Cr. Coupons ....$¢

When redeemed:
Dr. Coupons ....$¢
Cr. Sales ....$¢

When so handled, at the close of any year, the books will show accurate profits, and the credit balance in the Coupons account should be carried into the Balance Sheet to indicate the liability existing in favor of customers.

§ 139. Guaranteed Sales

Frequently, sales made are accompanied by a guarantee on the part of the seller to the buyer that the article or articles sold are free from certain defects in workmanship and that they are guaranteed in this particular for a certain length of time. In this connection, certain records may be desirable:

1. Guarantee Register
2. Register Index cards

The following rulings are illustrative in this connection.

Guarantee Register

No.	Name	Address	Kind Purchased	Date	Guaranteed For	Date Complaint Recorded	Date Repaired	Date Replaced

REGISTER INDEX CARD

Name ....
Address ....
....
Kind...................... Time............
Register No...............................
....

The Guarantee

THE BRADY STOVE COMPANY
Chicago, Illinois
No.............. Date...................
We hereby guarantee Stove No.......... to be free from defective workmanship for the period of one (1) year from date of this issue.
Signed......................
per........................
Secretary
Kind..................................

§ 140. Containers

Containers, such as bags, boxes, barrels, etc., are an important factor in certain lines of business activity. Sometimes, as in the case of cement bags, they are charged to the customer with the qualification that when returned by him in good condition a refund will be made of the amount charged. When defective containers are returned, credit is sometimes given, but the expense of repairing must be taken into account in determining the result of such dealing. When containers are charged to a customer, no sale has taken place; therefore, the trans-

action should be safeguarded in the accounts so that this fact is set out, and so that commissions will not be paid salesmen upon what is a necessary business expense. The procedure would be to credit some special account or accounts which are kept separate and distinct from the Sales account or accounts. The entries in connection with containers would be about as follows:

When containers purchased:
  Dr. Containers (through purchase Record) ....$¢
    Cr. Cash (or Accounts Payable).........$¢

When containers sent out to a customer:
  Dr. Customer (through Sales Book)......$¢
    Cr. Containers (for amount customer charged—through Sales Book) ....$¢

When containers returned:
  Dr. Containers (for amount of credit allowed through Returned Containers Record) ....$¢
    Cr. Customer ....$¢

The Sales Ledger rulings may be adjusted to include a column for Containers on both debit and credit sides, if it is desirable to separate thereon container charges and credits from other charges and credits to the accounts.

§ 141. Mechanical Appliances as Aids in Recording Cash Sales

Many mechanical devices are in use to facilitate the record of cash sales. When a cash sale is made, the customer should be given a receipt and a duplicate of that receipt should be retained for the accounting record. This has been mentioned in the early part of the present chapter. Whatever procedure is followed in recording a cash sale, provision should be made to eliminate the chance of possible peculation by the employees handling

the cash involved. The customer may or may not assist the employee in an attempted defalcation. If the customer is not a party to the fraud, the matter is not so difficult of solution, because all that is needed is to call the customer's attention in some way to the amount recorded by the employee. If the customer is an accessory to the defalcation, then the solution is doubtful. It may be that the fraud will be minimized by providing for recording the sale in the presence of others who happen to be nearby. Again, the matter of peculation may be minimized by a proper method of internal check, as discussed in a previous chapter dealing with cash records.

The cash register is supposed to assist materially in providing a check on the pilfering of cash, by virtue of the fact that the customer sees the amount rung up, the amount rung up appearing in a little window; also, because the amounts when rung up are printed or rather recorded within the machine; also, because a card with the amounts printed thereon, to be given the customer, drops out of the machine. Whatever advantage may be claimed for the cash register, there is a disadvantage in that the sales classifications in any one machine are limited in number at best; again, where more than one clerk uses a cash register (one with one drawer) it is difficult to ascertain who is responsible when a cash shortage is discovered. Modern machines eliminate this last criticism by providing one separate drawer for each clerk, and a separate bell to be struck when an amount is rung up. When a clerk is not "on the floor" he may lock his drawer so no one else can open it. Each clerk's sales are recorded and totaled in the machine, and the cash in each drawer may be readily checked against the proper total figure because it should agree therewith. The internal mechanism of the machine is hidden from view and cannot be seen unless one inserts a key in the proper place by

means of which the front of the machine opens; this key should be kept in the possession of the manager or of a responsible employee whose duty it is to check up the employees using the register. Whenever a full receipt is unnecessary, and when the sales classifications are not numerous, the cash register may be used to advantage in every system provided for the handling of cash sales.

Many other recording devices are made use of. The particular case under consideration demands a particular solution and care must be observed to see that the solution selected fits the problem that is to be solved; in other words, the machine must be adapted to its purpose.

§ 142. Mechanical Appliances as Aids in Recording Credit Sales

Since mechanical appliances to assist in recording charge sales are many, only the major types will be considered here. One device provides for making the original bookkeeping record and the customer's invoice at the same time. Such would be the duplicate bill book from which the original pen written copy is torn out and given the customer as his invoice, and in which the duplicate copy remains to be used later for entry in the sales records.

Another device provides for writing the original and duplicate upon a typewriter. Such would be the billing machine which is on the market in a number of styles. One type of machine writes both the original and carbon copy in typewritten style, the original to be sent to the customer and the duplicate to be retained in a loose leaf binder for the accounting record of the sale. Another type of machine does the same thing but provides for writing a number of carbon copies from rolls of paper placed in the machine.

§ 143. Illustrative Modern Sales Routine

To illustrate the bookkeeping routine revolving around sales procedure in a typically modern concern, the following example is given without any attempt being made to indicate possible variations. An order is received. When the customary preliminaries are completed in the order and credit departments, a duplicate sales invoice is made out upon a typewriter. One copy, the original, is sent to the customer; the other is used as the sales record. Each duplicate is posted individually to the debit of the proper customer's account in either a loose leaf, or card, detail ledger. These duplicates are then placed in numerical order in a loose leaf binder. At specified intervals, say, at the end of each month, these duplicate invoices are totaled on an adding machine, the machine total being used as the basis of a journal entry prepared on a loose sheet called a "journal voucher," the entry therefrom being posted as a debit to the General Ledger account of Accounts Receivable and as a credit to the Sales account.

Ofttimes, more than one customers' Ledger will be in use, each holding customers' accounts of certain initial letters, as has been explained in the chapter on Ledgers and the earlier one on Control accounts; for example, Ledger A to H, Ledger I to N, and Ledger O to Z. If so, the invoice forms in use for each ledger will be written either on different colored paper, or will be marked distinctively so that they may readily be sorted as to ledger groupings. The invoices (duplicates—the sales record) are sorted by ledgers, separate totals of each group being run off on the adding machine, and each such total is posted to the proper controlling account on the General Ledger (one control for each group). It may be that each control will be kept in each respective detail Customers' Ledger, one control on the General Ledger control-

ling the three separate controls. The posting routine may be so developed that when the invoices are made out, the debit entry to the various individual customers' accounts will be entered at the same time; this would be accomplished by the use of a bookkeeping machine containing a tabulating arrangement which will indicate automatically the total of all invoices made out.

When the customers' accounts are to be credited, the procedure is the same as already indicated, except that it is in reverse order.

For statistical purposes, sales analyses may be secured by the use of an electric sorting and tabulating machine. This machine bases its work upon a special card which has been punched by a punching machine in such a way that each hole therein represents by its position on the card some major fact as recorded on the original sales invoice.

When cash receipts are received for sales, they may be entered as received upon a loose sheet columnarized to set out the cash and discount amounts for each detail customers' Ledger; in some cases, one sheet may be used for each detail Ledger, in which case, before entry thereon, the remittances will be sorted by ledgers. These sheets are then totaled daily and given to the cashier for him to compare with his adding machine slip of remittances he has received during the day and which he will pay in to the bank. The cashier then enters in his General Cash Book the separate totals for each customers' Ledger. Subsequently, these sheets are sent to the Ledger keepers for entry in the various customers' ledgers; in this connection, the discount items must not be forgotten. These sheets are then filed for future reference in permanent binders.

To insure a correct balance of the customers' ledgers

at the end of each month, the daily debit and credit postings to the customers' accounts may be drawn off and compared with and balanced against the sales total on the adding machine slip, against the cash sheets, and against the credit memos.

§ 144. Department Store Charge Sales

The procedure followed in a department store for booking charge sales differs somewhat from the illustration shown above. It is about as follows: Charge sales slips are made out in duplicate. The original is given to the customer, and the duplicate is sent to the auditing department. There they are sorted by departments in order to secure the departmental analysis of sales. Then they are reassorted according to customers, and grouped according to the controlling accounts carried, each group total being run off on an adding machine for checking purposes. Each group of tickets is then turned over to a billing machine operator for entry against the customers. There is one operator for each group,—the number of operators determining the number of classes into which customers are divided. These operators, at the beginning of each month, take a folded billhead perforated at the fold, the duplicate thereof being wider than the original so that eventually it may be kept in a loose leaf binder. On these billheads are placed the name and address of each customer who purchased goods that day and the charges for the day are entered therein from the sales slips; subsequently, as new customers purchase goods billheads are made out for them. At the end of each day, the total amount of charges as entered by each operator is taken from the machine and is checked against the total retained in the auditing department. This checks the work of each operator. The only possible error

would be that a charge as entered may be charged to the wrong customer. The sales are entered in black ink; the credits for returned goods are entered in red ink. For the credits, a separate total is secured daily, which total is compared with one furnished by the auditing department to prove the work.

When the daily proof has been secured, these customers' bills are either given to the bookkeepers who charge each customer's account with the day's purchases as shown, or the bills are filed daily until the end of the month. If the latter procedure is followed, at the end of each month each bill is added and the black and red ink totals inserted. The totals of all debits and credits are taken off on the adding machine, after which they are balanced against the totals compiled in the auditing department, the total credit sales for the month. After errors are corrected, the bookkeepers use the bills to enter the total monthly charge to each customer's account. At the end of the month the original copy of the bill is torn from the duplicate, the previous month's balance is entered thereon, and the necessary cash entries representing current payments on account,—and the amount now due is secured. The original copies are sent to the customers and the duplicates retained. The customer receives an itemized bill, and the duplicate is filed away as the detail of his Ledger account in case of argument relative thereto.

This method of handling charge accounts requires but little more work than would be necessary to make out a single bill, and in addition it is possible to get the bills out on time, to secure an absolute agreement between the Ledger accounts and the bills, to clear the Ledger accounts of unnecessary detail, and to check the total of the billings against the total of the sales tickets. It will therefore be seen that this method is perhaps the most efficient.

§ 145. Business Statistics Based Upon Sales

Mercantile establishments very often utilize statistics in their work in connection with facts based more or less upon the sales activities. This would be especially true of an enterprise handling a number of different lines of goods.

In connection with sales, the figures compiled are generally with one or more of the following:

1. Sales may be compared by totals, cash and credit sales, departments, salesmen, territories, lines of goods sold, percentages to total, new business, etc.
2. Stock on hand may be compared according to sales price, quantities sold, percentage of sales
3. Cost of doing business may be determined as a percentage of sales made
4. Collection expenses may be determined as a percentage of sales
5. Notes due may be compared with sales made
6. Goods returned may be compared in a similar manner
7. Turnover comparisons may be based upon the number of sales made

§ 146. Sales Recapitulation

Regardless of the manner in which sales are recorded, it is necessary to secure the total sales of each kind so that the proper credits may be made to the various Sales accounts. If this is not done upon the Sales Book itself, it must be done upon a subsidiary record, a recapitulation sheet. Such a sheet is columnarized with as many columns as there are departments, or subdivisions made of the sales. The following divisions would suffice where a business is departmentalized and where the customers' Ledgers are kept by territories.

Date
Invoice Number

Total
Distribution
- Departments
  - A
  - B
  - C
  - D
- Ledgers
  - City
  - Wholesale
  - Eastern
  - Western

§ 147. Salesmen's Records

Many times a salesman receives a commission in addition to his salary. And to this end, the sales record is important. His commission or bonus may be based either upon the total sales made, or upon sales of certain kinds of goods (as where it is desired to move old stock).

When the commission is based upon the amount of the sales, the sales ticket is the original source of information. At stated intervals these sales tickets are sorted according to salesmen and the daily total for each salesman is then entered upon a special sales recapitulation sheet, the sheet being either separate or part of the sales record. This total secured for each salesman should be checked against, and be equal to, the record of the day's sales as recorded in the back of the salesman's book of sales tickets. Each such recapitulation sheet is totaled monthly, and the commission to be paid is based upon each such total. The total sales for the month should be checked against the sum of the monthly total for all salesmen, since the two totals should be equal.

If the commission is granted only upon sales of certain kinds of goods, each sales ticket covering a sale of such goods should be earmarked so that the salesmen's records can readily be prepared therefrom.

These salesmen's recapitulation records should be kept even though the men have no commission interest based thereon. Such records will indicate individual efficiency to be referred to when salary increases are contemplated.

§ 148. A "Set" of Books

Experience shows that it is difficult to answer the question, "What constitutes a set of books?" The bookkeeper usually will say that a set of books comprises all those books, and no others, which are required for the production of a Trial Balance. These books may be all those that are in use, or only part of them. The nature of the business determines how many should be included. In a retail grocery, for example, the Order Books form the basis for the entries made upon the balancing books, and yet are not part of them. In a manufacturing concern, there are many books holding figures in a manner preliminary to the entries made upon the cost records. Such books are important, but they could be destroyed without in any way interfering with the records made in the books necessary to the production of a Trial Balance.

Some records may be partly within and partly without the system proper; as for example, the departmentalized Purchase Record. The total column holds items which are posted individually to the credit of the individual accounts in the creditors' Ledger, and the total of each departmental column is debited to the departmental Purchases accounts. The analysis as between departments matters not, so far as the balancing feature is concerned. The total column need not even be added, because said total may not even be transferred to the Ledger. This addition could not, of course, be wrong, while that of the analysis column was correct.

Only items posted to the Ledger are involved in the

balancing process. How they are made up, and whether they are wrongly or rightly made up, matters not. For bookkeeping purposes, the bookkeeper should see that they are right in fact; but if he alters one, he should remember that if the figure has been posted already an alteration of a similar nature must be made in the Ledger. If the alteration affects the totals of the analysis columns, an alteration in one may require that an alteration be made in the other.

Therefore, it may be said that, basically, a set of books consists of the Journal and the Ledger. They are all sufficient for all purposes if one only has in mind the entering of debits and credits. It is the modern business and the fact that a great volume of work must be got out within a short period of time that make it necessary for both of these basic records to be divided and subdivided and recolumned until we have what seemingly is a complicated set of records.

§ 149. Conclusion

The last four chapters have been devoted to a discussion of Journals. First we started with the simple Journal as a memorandum or diary record of entries to be made later in the ledgers. Then it was noticed that as soon as a business reached any considerable size it became necessary to adopt some short cut to pare down the volume of work falling upon the shoulders of the keeper of the simple Journal; the first short cut plan in this connection was to add columns, both debit and credit, to the simple Journal in which to accumulate repetitive entries so that at the end of the month only totals required posting where formerly every entry had to be posted in detail.

As a business expanded and the number of accounts, and the number of entries to these accounts, increased, a corresponding expansion of the columnar Journal was

noticed until a point was reached whereat the record became:

a) Unwieldy and difficult to handle

b) Errors crept into the work regardless of the amount of care exercised; the use of too many columns caused this

c) Waste paper space was noticed; each entry required a whole line from left to right across the page

d) A time came when the transactions were so numerous that one bookkeeper could not handle them; the columnar Journal up to this point of development, did not permit of more than one bookkeeper using it at a time

On account of the four objections noticed above, the next progressive step concerned splitting the columnar Journal into a number of separate Journals, each recording only one specific class of items. To do this, the special columns which had been added to the simple Journal were taken away therefrom, and from each such pair (one debit and one credit) of columns a new Journal was made. Thus, next we have the separate Journal for purchases, for sales, for cash, etc. By a process of column abstraction, a number of special Journals were developed from the simple columnar Journal. In this process of creating a number of books out of one book, the Journal function has neither been changed nor destroyed in any particular. The Journal still exists; it might consist of one book or it might consist of a dozen.

After having stripped the columnar Journal of all classes of repetitive entries, the transactions left to be recorded therein are merely those which are of indefinite recurrence,—miscellaneous and unusual transactions; such as: opening entries, adjustment entries, and closing entries.

In turn, these separate Journals have been developed

on the columnar principle, some in a simple manner, others elaborately. The development is dependent upon the business which is to use them; the small candy shop may have one kind, the $10,000,000 corporation another.

In conclusion, remember that the purpose of special columns in a Journal is to gather together and classify entries so that they may be posted in totals to the General Ledger and in detail to the Subsidiary Ledgers. Remember, however, that the General Ledger does not necessarily require all postings thereto to be made in total, although on account of the great use being made of controlling accounts in a large business the General Ledger more and more is becoming a Ledger of controls,—a Ledger holding only primary accounts. Unusual transactions occur from time to time, but since for them it is unnecessary to set aside in special Journals special columns for their collection, we find them placed therein in a "Sundries" column from which they are posted in detail, as desired, to the General Ledger.

Do not be confused by the name attached to an accounting record. Ascertain its purpose, and find out what relation it bears to the General Ledger. If postings are made therefrom to the General Ledger, it is a Journal. If postings are not made therefrom, but instead it contains in detail items which in total are found in a General Ledger account, it is a subsidiary or underlying Ledger.

CHAPTER VII

PART I. STATEMENTS: EXHIBITS, SCHEDULES, CHARTS

§ 150. Introduction

In the previous volume considerable attention was devoted to the preparation of statements. It was noticed that the entire object in statement preparation resolves itself into a proposition of displaying the items therein to be contained in the best possible interpretative manner. In other words, there is here a similarity of these underlying principles with those made use of by an advertising man.

It was noticed, also, that the business facts, as classified and recorded in the accounting records, were, at some time or other, usually recapitulated into statement form for the scrutiny of interested parties. The basic accounting statements were found to be the Balance Sheet and the Statement of Profits and Income; the former discloses financial position, and the latter, financial progress.

§ 151. Relation of Statements to Accounting Records

These statements are written up after the books have been adjusted and closed. Their preparation is a matter of constructive accounting, inasmuch as their ultimate form is not wholly dependent upon set rules. One statement, in its final presentation, may be radically different in set up from that followed in the preparation of a previous statement. As mentioned above, the salient points to be brought out should govern statement struc-

ture except in certain cases where legal requirements make it necessary to construct statements according to a set model.

Since the Balance Sheet and the Statement of Profits and Income are prepared usually from a set of facts recorded in accounting records, a marked relationship, from the constructive point of view, exists between the account classifications as carried in the books of account and as used upon the statements. Unless the two dovetail together, valuable time is lost in attempting their preparation. Again, many questions about a business which may be of interest to the manager, must be left unanswered by whatever classification of accounts is adopted for a Ledger. To answer these questions, statements must be prepared. Thus are indicated the basic reasons for considering statements again at this point of our work.

§ 152. Place of Statement Design in System Construction

In the first chapter of this volume, it was seen that statement construction was set out last as the final main subject for discussion under the division of constructive accounting. However, bear in mind carefully and clearly the exceedingly important fact that the subject of statements is not the last one to which an accountant turns his attention when installing a system of accounts. In the very first chapter of the previous course, Volume No. 1, emphatic mention was made that the ultimate aim and object an accountant always should have in mind when on a case is the production of an intelligent statement or statements. A statement is prepared before a set of books is opened, and statements are prepared periodically when the books are closed. Therefore, if the production of intelligent statements is ever in mind, it stands to reason that, as the accountant begins installing his classi-

fication of accounts, he should solve the two angles of his system problem together.

The account classifications and statement forms go hand in hand and, practically, it seems to the writer, an accountant would be a very weak member of the profession were he to commence designing the rulings of his contemplated records before he had decided upon the classification of accounts he contemplated using and upon the statements to be used in connection therewith. If any other method is followed, considerable expense may be incurred by the client on account of required changes being made necessary in the rulings as adopted. Under such conditions, if these changes are not made, perhaps 50 per cent. efficiency, from an interpretative point of view, will result.

§ 153. Exhibits Versus Schedules

Every important point with regard to the results indicated from an examination of any recorded set of business transactions may the better be brought to light by means of an exhibit or schedule. Accountants in making up reports for clients refer to the Balance Sheet and to the Statement of Profits and Income as "exhibits." Statements prepared to explain or support an item or group of items in either of the above mentioned exhibits are referred to as "schedules."

§ 154. Statement Readers

Statements are of interest to the owner or owners of a business, to managers, executives, creditors, and at times to the public in general. Prospective investors desire the same general information as is given the owner.

The owner is interested, primarily, in the business net worth and in the reasons for its increase or decrease. Managers and executives are interested in statements to

learn of the concern's present financial status, and what has been accomplished in the past over a period of time, in order to plan for the future expansion.

The creditor, including the banker, are particularly interested in the concern's solvency; what is the condition of its cash and other assets which can, if necessary, be quickly converted into cash; and what liabilities must be met at an early date. To them, the Balance Sheet is all important, and the current assets and liabilities more important than the fixed assets and liabilities; they are interested, primarily, in determining what chance they run of getting their bills paid when these fall due.

From the Balance Sheet point of view, the investor is vitally interested in the fixed assets, these representing the income producing properties of the concern. He may be interested, also, in the income statements to determine what he may hope for in the way of steady dividends. The public in general, if interested at all in a concern's statements, are interested therein, usually, from the standpoint of either investor or creditor.

Therefore, in statement preparation, the accountant should always bear in mind the fact that the statements he prepares may be examined critically by a number of classes of interested persons. Of course, he must prepare them with the basic purpose in mind for which they are to be used; otherwise, he will fail in bringing out the salient points of the business as related thereto. Again, he should remember always that although the men within the business, as the managers or executives, may not be familiar with bookkeeping sufficiently to criticize intelligently statements prepared for their examination, the statements he prepares may come into the hands of certain persons outside the business who are excellent accountants and who, therefore, are in a position to criticize them in an able and competent manner.

§ 155. Brevity and Neatness

Every professional accountant at some time or other has had the experience of doing an excellent piece of work for a client and then have the client evidence surprise and indignation at the amount of the fee asked for the work done, basing his attitude upon the fact that the statements with their accompanying report consist of only a few pages of typewritten matter. Some accountants try to overcome this objection by padding their reports with all sorts of schedules and all manner of comment possible. Frequently, reports are met with containing a copy of the preclosing and postclosing Trial Balances, schedules of Accounts Receivable and Accounts Payable, schedules of Bank Reconciliations and, in fact, all sorts of "driftwood," with the idea of trying to impress the client with the volume of work that has been done. Likewise, other so-called "accountants" are guilty of this type of practice through ignorance, the inability of distinguishing the essential from the non-essential.

Ordinarily, such methods are to be deplored; only occasionally does an accountant meet with a case in which such detailed schedules are a necessary part of the report. An accountant should say what he has to say in the fewest number of words possible, and make up for an apparent scantiness in the size of a report by the use of extreme neatness and picture-like appearance. Infinite care should be used in statement preparation. Such things as ink spots, smears, and erasures should never be tolerated in the completed typewritten report. Colored ink may be used in statement rulings; the proper and judicious use thereof will set off statements to advantage. In every way possible, one should give his statements an impressive appearance, and eliminate non-essentials. It is scarcely necessary to add that the sense or completeness of a report should never be sacrificed for the sake of beauty.

§ 156. Statement Forms: Report Versus Account Forms

In Volume No. 1, it was noticed, also, that there existed two general ways of statement arrangement: the report form and the account form. In the report form of statement, facts are set out in a vertical manner, from the top of the sheet downward. When properly prepared, this statement is simpler for the layman to read than is the account form of statement. However, such a form of statement is more difficult to prepare than the account form, because the facts to be displayed therein must first be rearranged in a manner that will permit of their presentation being both simple and effective; and this rearrangement is often more of a difficult task than would be the rearrangement of the same set of figures for a statement set out in account form. The report or running form of statement is easily written on a typewriting machine with a standard keyboard; many offices do not have any but machines with standard keyboards, and if their statements were prepared in account form, a special machine and paper would be required for the work,—which means an unnecessary additional expense.

The account form of statement has the appearance of, and follows the arrangement of, a double entry Ledger account. When the Statement of Profit and Loss is set up in account form, as was noticed in the first volume, it is still a statement, and should be designated as such. When in account form, it is practically an exact copy of the Profit and Loss account as carried upon the Ledger. Likewise, a Statement of Cash Receipts and Disbursements, when arranged to show cash receipts on the left side of the sheet and cash payments on the right, is practically a copy of the Cash Book. The Balance Sheet, also, may be arranged in account form.

The account form of statement is more technical in its nature than the report form, and is not so easily inter-

preted by the layman as is the latter; one must have some knowledge of double entry principles at least before he can comprehend the account form of statement in an intelligent manner. For one who understands bookkeeping principles thoroughly, the account form of statement, at least as concerns the Balance Sheet, is perhaps to be preferred over the report form. Its arrangement lends assistance in comparing and analyzing facts as therein displayed; this assistance is not secured from using the report form.

The technical limitations on the use of the account form of statement are the opposite of the points mentioned above in favor of the statement in report form. Much more horizontal space is required on a sheet for the proper setting out of figures. This fact usually makes it necessary to use a wider sheet of paper than the standard width, and this in turn makes the regular typewriting machine with a standard carriage useless. And, as mentioned above, when a wide carriage machine is purchased for such use, the concern so purchasing is put to an additional expense not necessary when the report form of statement is used.

So far as the Balance Sheet is concerned, whether set up in report form or account form, the items therein, basically, may be grouped in either of two ways:

1. Assets
    - Current
    - Deferred
    - Fixed

   Liabilities
    - Current
    - Deferred
    - Fixed
2. Assets
    - Fixed
    - Current

Deferred
Liabilities
Fixed
Current
Deferred

The item of capital, in either case, may precede or follow the liabilities. This phase of the matter has been thoroughly covered in Volume No. 1.

When forms of statements have been adopted as satisfactory, they should not be changed except for good and excellent reasons. To do so, tends to break down the means of securing ready comparisons, one period with another. But if changes are desirable, they should be made with care, and at all times, in connection therewith, due and careful consideration should be given to the existing classification of accounts.

§ 157. Periods of Time Covered by Statements: Financial Periods

Time is divided into periods, years, months, weeks, days, hours, minutes and seconds. Some of these divisions are natural, others arbitrary. Years, months and days are natural divisions, being governed by the laws of nature. Hours, minutes and seconds are divisions made by man. In accounting work, the records are made by years, months and days. In stock exchange work, financial transactions may require the recording of the hour and minute at which they take place. Business transactions, usually, are entered in the order of their occurrence and under the date of the day upon which they take place.

Normally, in business, a twelve-month period is used as a basis for comparison, being called the fiscal year. This fiscal year may, or may not, be in agreement with the calendar year. The period is usually of this length

in order to secure all the seasonal fluctuations which may affect the business. And it is assumed, ordinarily, that each twelve-month period will be subject to the same seasonal fluctuations and changes.

Because of this normal condition, it is usual to prepare the basic statements, the Balance Sheet and the Statement of Profits and Income, upon the basis of a twelve-month period. At the close of each fiscal year, a Balance Sheet is prepared to set out financial condition, and a Statement of Profits and Income is prepared to show the operation results during each fiscal year.

However, it must be remembered that frequently statements prepared at shorter intervals are valuable, the usual shorter period being the month. Some concerns even arrange their accounting records so that statements may be drawn at the close of each day's business; a considerable number of them have a system whereby statements relating to cash and sales are prepared daily, the other statements being prepared monthly and yearly.

§ 158. Importance of Inventories in Statement Preparation

In connection with statement preparation, one should remember, also, the important part played by the inventories. In fact, complete statements depend, basically, upon the securement of proper inventories. If monthly inventories of goods cannot be secured from the records, many concerns, especially trading concerns, finding it impracticable for their purposes to carry a going inventory record, the monthly statements cannot be prepared without resorting to the expedient of approximating the inventory by using the gross profit on sales percentage. This latter method, usually, secures a result sufficiently accurate for working purposes. The method has already been discussed in detail in Volume No. 1, but may be reviewed briefly at this point.

The sales figure is known, and the percentages of gross profit on sales based upon, say, the average of a two or three years' period is known. The gross profit is then calculated in money value and deducted from the sales figure; the resultant is a figure approximately equal in amount to the cost of the goods sold. Next, the amount of opening inventory and the amount of purchases are added together and the amount of the cost of goods sold deducted therefrom. The resultant is the present approximate inventory which is, as a rule, sufficiently accurate to use in the preparation of the monthly statements. At the close of the year, when a physical inventory is taken, differences are adjusted.

No matter how short the period of time at the end of which statements are prepared, care must be observed in making sure that all accruals are taken up on the records in a manner similar to showing them at the end of the regular fiscal year. Likewise, all information should be so handled upon the records that these short interval statements will be completed within two or three days after the close of each such period. Delays in this connection should not be tolerated; if necessary, on account of the fact that certain data cannot be secured at such times, its amount should be estimated, the estimate be included in the statements, subject to an adjustment being made later when the actual facts are ascertained.

§ 159. Statement Percentages

Percentages are used frequently in statements as a means of showing in a clear-cut manner the relationship existing between amounts. First, let us consider percentages in relation to the Profit and Loss accounts.

A correct definition of profit depends upon whether one defines the term from the point of view of business or from the point of view of an economist. Thus far in our

work it has been defined from the business, or investor's, point of view. The two definitions run parallel, so to speak, with those of accounting capital as against economic capital. The economic definition considers profit as a return from the entire business, regardless of whether property is owned, rented or borrowed. The business definition considers profit as a return on the owners' net equity in a business. The latter definition is the one best understood, and the one most in use; current bookkeeping methods do not distribute the earnings of a business first as between rent and interest and then consider the remainder as profit.

It is not sufficient for a merchant or a manufacturer to know only the amount of profit he has made during a certain period of time. He should know how this profit arose, and to this end he will examine closely the various items and classes of items displayed in the Profit and Loss Statement. If, over a period of years, the accounts have been kept in a similar manner, and the Statement of Profit and Loss prepared in uniform style, the reason for any variation in profit may, by comparison, be readily ascertained, and any business deficiency or weakness located so that the proper steps may be taken to prevent a further recurrence. Prompt action in this particular may avert disaster. If net profit has decreased, the cause may be:

1. Decrease in turnover
2. Decrease in prices, without an increase in sales
3. Increase in cost
4. Increase in expenses
5. Some combination of (1)—(4)

To secure an intelligent basis of comparison over a period of years the Profit and Loss items must be reduced to a common denominator which is accomplished, say, by determining the ratio each item in a series bears to the net

sales or to the cost of goods sold. By so doing, the relationship between amounts may be clearly shown. If, in a Profit and Loss Statement, it is seen the net sales are $150,000, the net cost of goods sold $52,000, the gross profit $48,000, and the selling expense $13,000, the relationship between these amounts as set out may be difficult to interpret quickly. But if, say, net sales is used as a basis, and percentages are calculated, the opposite usually is true: Net cost of goods sold is 34.06%; gross profit 32%; selling expense 8.66%.

Percentage calculations in arithmetic texts use cost price as a basis; ordinarily, this is the case. This basis is used, also, in business except by those engaged in merchandising. In the latter instance, percentage calculations are based upon sales price. The most elementary principles of mathematics are sufficient to mark this latter practice as incorrect. But although in theory percentage calculations on cost are desirable, the practice among merchants of using sales price as a basis of computation is so invariable that in practice the method must be recognized and adhered to. Mr. R. H. Montgomery, C.P.A., says:

> "It is, perhaps, well to note that, in accordance with the invariable custom of traders, percentages of gross profits are based upon the selling price of the goods, and not on the cost price."

In statement preparation, therefore, an accountant must consider the nature of the business for which the statement is to be compiled, and then set out clearly the basis upon which he has calculated percentages.

Since there is no set standard used as a basis, the lack of this information as to the basis upon which percentages have been calculated makes the statement unintelligible. For example, were the percentages figured on

Sales
Costs
Unit of product
Investment
Etc.,

no one knows unless the statement clearly points out the key. One basis frequently used, and one which is well understood by business men in general, as well as giving rise to a conservative figure, is net worth as understood by the accountant,—i.e., assets less liabilities.

§ 160. Percentages in Fixing Selling Price

Since expenses are more or less definite, the sales price being the fluctuating item, the use of percentages in fixing selling prices is very important. Suppose the expenses for a business amount to 25% of turnover, and a net profit of 10% thereon is desired. The total of these two percentages is 35%, but 35% could not be added to cost in order to secure the sales price. If the selling price is $100, the cost is evidently $65, and the amount reserved for profit and expenses being $35, the expenses and profit borne by each $1 of original cost is 35/65. $100 of cost must bear 35/65 x 100/1, or 53.8%. Therefore, if a net profit of 10% is desired, based on sales price, of which original cost is 65% and expenses 25%, there must be added to the cost price 53.8% to determine the selling price. If an article cost $5, and 35% is to be added thereto to secure sales price, the result is $6.75. Of this sales price, 25% is required to cover expenses, or $1.69; the result is that the actual sales price is $5.06, the profit being 6 cents, which is 1 2/10%, not 10%. The correct selling price is $7.69 plus. Of this amount, $5 is the original cost, $2.69, or 53.8%, the amount necessary to cover extra expenses, and 77 cents, or 10%, the profit:

Cost	$5.00
Add—53.8%	2.69
Sales price	$7.69
Less—Expenses 25%	1.9225
	$5.7675
Less—Cost	5.00
Profit, 10%	$ .7675

Losses frequently are incurred on account of not understanding this principle.

§ 161. Graphic Presentations

The better to show the rise and fall in purchases, sales, gross profit, and expenses, graphic curves are of great value. By their use, a person with but slight knowledge of the relative value of numbers may grasp at once the major idea thrown forward by a series of figures. Even when columns of figures have been reduced to percentages some may find difficulty still existing in readily determining their relative importance period by period.

But when the figures are displayed in the form of pictures, diagrams, charts and curves, their effect is readily seen. Even if persons are adept in interpreting percentages, a graphic chart will be of great help in the saving of valuable time; one glance at a sheet in chart form will show the trend of a certain series of related facts over a number of periods of time. Frequently, facts which would escape notice entirely if left among the many items of the books buried among the many figures of a dozen or more columns, are brought to light by being charted, and so receive proper attention.

One of the most important uses of charts is to compare the results of the operations of one period with those of

another. For example, the monthly sales of each line of goods may be compared month by month over a period of one or two years, and the total sales each month during the same period of time may be compared month by month. All these figures could be placed on the same chart, if desired, different colored inks being used for each line of goods and for total sales. If only two sets of figures are compared on one chart, one set may be represented by a solid line, and the other by a dotted line. Comparisons, graphically, might also be made as between total sales, expenses, and profits of two or more periods; as between inventories of goods on hand, sales, and purchases of a period (to see how much money is tied up in stock to meet sales); and as between various expenses, month my month, over a considerable period of time (to detect possible leakages). The above indicate a few of the possible uses for graphic presentation.

The period of time used in the comparisons may be other than a month, as a day or a week. This depends upon the conditions of the business under review. A summer hotel company might well find it advisable to use weekly comparisons rather than monthly comparisons due to the shortness of the summer season.

§ 162. Comparative Statements

Frequently, an accountant is called upon to account for the increase or decrease of profits as shown by statements covering two or three years or more. Basically, the process involved is one of combining the two or more statements into one, calling the latter a comparative statement.

For example, the Profit and Loss Statement may show a net loss for 1919, in the amount of $5,000. The management, perhaps, wish further information concerning this figure than is displayed in the Profit and Loss Statement.

A simple solution would be to prepare a Comparative Balance Sheet which has already been discussed in its basic essentials in Volume No. 1, in connection with Single Entry. The object of a Comparative Balance Sheet, however, may not always be to account for increases or decreases, as much as to show the changes in the individual assets and liabilities. In connection with double entry, a merchant may desire to know just how certain items this year compare with similar ones of last year. He may wish to know just how this year's cash balance compares with that of last year, how much cash is being absorbed in the purchase of new assets, how the accounts receivable this year compare with those of last year, etc.

In connection with the Comparative Balance Sheet, it may be desirable to make use of a Comparative Statement of Profits and Income. In the above simple example, the $5,000 loss might have been incurred in the face of the fact that sales this year were far in excess of those of last year. If so, the Comparative Profit and Loss Statement might be of more value to the concern than the Comparative Balance Sheet. However, it might be advisable to use both of them.

Again, if in the above example the profit for the year was $5,000, and if $10,000 additional capital had been introduced, and if at the end of the year the cash balance was low, it might be desirable to learn what had become of the earned profit, and of the new capital. What liabilities have been decreased, what increases have there been in goods inventories, in accounts receivable, in new equipment, etc., are some questions that may require an answer. The ordinary Balance Sheet or Statement of Profits and Income will not answer these questions. The proper compilation of a Comparative Balance Sheet may do so.

A variation, so to speak, of the comparative statement

principle is met with in large organizations in the form of what is known as a Statement of the Application of Funds. This will be discussed later in connection with corporations.

One should bear in mind that, as a rule, the idea of comparison is secondary to the main function of an accounting statement. Primarily, a Balance Sheet shows financial condition as at a specific moment of time, whereas, primarily, the Statement of Profits and Income shows financial progress between two dates,—the beginning and end of a certain period.

A Comparative Balance Sheet is not as common in ordinary business concerns as is the Comparative Statement of Profit and Loss. Frequently, where monthly income statements are prepared, a column or columns are added in which to show a comparison of the present month with the same month of the last year, and to show a comparison of all the months in the total to date of the present year with the same months in total of the past year.

Finally, in comparisons of any kind, one must be careful to see that the conditions of one period are similar with those of the other, the two being compared. Without doing this, the value of comparisons may be entirely lost. Even when the periods of time are the same in length, certain outside conditions may make the comparison in error, if the latter have not been taken into consideration. For example, the sales during June of a certain year in a certain department store were greatly in excess of the sales for June of the following year. Conditions apparently were the same, at least so the accountant was told. Still, since the increase was not normal, he went outside and sought for the reason by inquiring around among the business men in the community. Soon his inquiry bore fruit. The abnormal excess was caused

by a circus which had attracted people to the city, and also because the weather that month had been excellent, whereas, during the same month of the present year there had been a considerable number of rainy days.

§ 163. Miscellaneous Statements

The number of miscellaneous statements that an accountant may prepare from a set of books is great, depending upon his ability to analyze and interpret conditions as they exist, and upon his knowledge of what information will be useful under an existing set of circumstances. Some of the more common ones are indicated as follows:

1. Receipts from personal accounts month by month
2. Sources of accounts receivable month by month,—as from sales, cash loans, etc.
3. Sales as against advertising cost month by month
4. Monthly analysis of sales, as to number of sales to each customer (or important customers) and total amount
5. Notes receivable and notes payable in detail, classified as to date and amount,—as where note registers are not in use
6. Etc.

§ 164. Statement Reconciliation

Frequently, when an accountant is called in on a case to prepare a Statement of Profits and Income, he finds that some one in the organization has already prepared such a statement; and his solution may differ considerably from the one already existent. In such cases, it is of great advantage to reconcile the new statement with the old one. It may be, for example, as is usually the case, that the regular Profit and Loss Statement can-

not be made the basis of the Federal Income Tax Return, certain items therein contained not being allowed as deductions from the income shown as having been earned. In such a case, a reconciliation statement is invaluable and absolutely necessary, because the information thereon contained must be included in a certain section of the tax return. The underlying principle in this connection has already been shown in connection with the discussion previously given for reconciling the Cash Book balance with the bank account.

Part 2. Bookkeeping Review

§ 165. Introduction

For the purpose of providing review practice in the mechanics of keeping a set of double entry books, and for the purpose at the same time of illustrating some of the points brought out in various preceding assignments, the second part of the present chapter, and also of the next one, will consist of a set of transactions to be entered upon forms ruled by the student. The first half of this work is given in this chapter and the last half of it in the next one. The student should make a conscientious effort to complete all of the work in connection therewith by the time the subject of partnerships has been concluded.

The various books to be used are to be ruled by the student according to directions given below. In ruling up these books, and in making the entries in them, neatness and legibility must be insisted upon to an extreme degree. These qualities promote pride in one's work and by lessening the chances for error in posting and taking trial balances tend to a saving in time and effort.

§ 166. Books Used

The books used in this work will consist of:

General Journal	Petty Cash Book
Purchase Record	General Ledger
Sales Register	Customers' Ledger
General Cash Book	Creditors' Ledger

The forms should be ruled on paper which, when folded, will produce a size about $8\frac{1}{2}$ x 11 inches. When a sheet is folded, the ruling should be found on the inside, i.e., on the two inside pages. Every transaction given must be entered in the proper record, and each entry should be made as the student comes to it.

§ 167. Book Rulings

The General Journal should be ruled to provide the following columns from left to right across the page:

General
Accounts Payable
Accounts Receivable
L. F.
Explanation
L. F.
Accounts Receivable
Accounts Payable
General

The Purchase Record should be ruled as follows:

Date
Invoice Number
Accounts to be Credited
Explanation
Terms
L. F.
Total-Credit
Purchases
- Furnishings
- Men's Clothing
- Boys' Clothing
- Shoes

Cartage
Sundries
  Account
  L. F.
  Amount

The ruling for the Sales Register is:

Date
Bill Number
Charge
  Cash
  Customer
L. F.
Accounts to be Debited
Explanation
Terms
Distribution
  Furnishings
  Men's Clothing
  Boys' Clothing
  Shoes

The suggested ruling of the Cash Book is:

Receipts Side:
  Date
  Accounts to be Credited
  Explanation
  L. F.
  General Ledger
  Customers
  Discount Allowed
  Net Cash
  Bank Deposits

Payments Side:
  Date
  Accounts to be Debited
  Explanation
  L. F.
  General Ledger
  Creditors
  Discount Received
  Checks
    Number
    Amount

The ruling for the Petty Cash Book is:

Date
Explanation
Receipts
Voucher Number

Total Payments
Distribution
  Carfare
  Postage
  Stationery
  Sundries
    Account
    L. F.
    Amount

§ 168. General Ledger Accounts

On the sheets to be used as a General Ledger, the following accounts should be opened in the order given, three accounts to the page:

Assets:
- Petty Cash Fund
- Cash in Bank
- Customers' Accounts Receivable
- Notes Receivable
- Furniture and Fixtures
- Reserve for Depreciation of Furniture and Fixtures
- Automobile
- Reserve for Depreciation of Automobile

Liabilities:
- Creditors' Accounts Payable
- Notes Payable
- Notes Receivable Discounted

Proprietorship:
- Jones, Capital Account
- Brown, Capital Account
- Jones, Current Account
- Brown, Current Account
- Profit and Loss

Income:
- Men's Clothing, Sales
- Boys' Clothing, Sales

Furnishings, Sales
Shoes, Sales
Discounts Received

Expenses:
Men's Clothing, Purchases
Boys' Clothing, Purchases
Furnishings, Purchases
Shoes, Purchases
Freight and Cartage Inward
Wages
Freight and Cartage Outward
Automobile Expense
Advertising
Office Salaries
Traveling Expense
Depreciation
Carfare
Postage
Stationery and Printing
Sundry Expenses
Discounts Allowed
Rent
Insurance
Bad Debts

§ 169. Handling of Discounts

When a payment is to be made, and a discount to be taken, two methods may be made use of in their handling. Suppose a purchase of clothing in the amount of $10,000 has taken place, and part of this bill has been paid in cash, $8,000, a discount of 6% having been received on the part paid. The $8,000 paid in cash is not the amount for which credit is taken. The $8,000 is 94% of the amount for which the vendor will give credit on his books.

Again, and this is the usual way a transaction is handled when a discount is received, the amount of the bill is stated plus the percentage of discount allowed thereon. The discount is deducted from the bill to ascertain the net

amount to be paid. This system is very simple, but has been proved satisfactory.

§ 170. Opening Entry

The business illustrated is that of a partnership. A summary of the Articles of Copartnership should be placed in the General Journal, on the first page thereof.

January 2, 1920.

Jones and Brown, both of Syracuse, have this day formed a partnership to conduct a wholesale men's furnishings business under the firm name of

JONES & BROWN

Jones contributes, as his share of the firm capital, the sum of $30,000 in cash, $25,000 to be paid in cash at once, and the balance within ten (10) days. Brown contributes, as his share of the firm capital, the sum of $45,000 in cash, $10,000 to be paid in cash at once, $20,000 to be represented by two notes receivable of $10,000 each payable in thirty and sixty days, and the balance to be paid within ten (10) days. The contributions of both partners represent a total

CAPITAL OF $75,000.00

Profits and losses are to be shared equally.

§ 171. Transactions

The transactions for the month of January are given below. Consider that all goods purchased or sold are delivered and accepted at the time of the purchase or sale.

2. Jones pays in $25,000 in cash
   Brown pays in $10,000 in cash
   Brown turns over two notes, one thirty day note for $10,000 and one sixty day note for $10,000
   A five year lease is taken on a store building at 913 Sansom Street, the rent for the first year being paid in cash, $2,000

3. Fixtures in the amount of $5,000 are purchased from the Standard Fixture Company, terms 2/10; n/30

   Office furniture is purchased for cash, $500, from Smith-Duggan Company

   Men's clothing is purchased in the amount of $10,000, from Chas. Marks & Co. Cash is paid thereon in the amount of $4,000, and a 6% discount is allowed on that payment

   Boys' clothing is purchased for $4,200, cash; a discount of 8% is secured from the vendor, J. Cohen & Co.

   Miscellaneous furnishings are purchased from The Mentor Co. for $4,500. $2,000 is paid in cash with a discount of 7%. The unpaid balance is on the terms 5/30

   The following purchases were paid for in cash; discount 6%:

   Johnson Co., Shoes; amount of invoice $3,600

   Brown Jennings Co., Men's Clothing; amount of invoice $3,800

   Gaylord Jones Co., Men's Clothing; cash paid $4,100

   J. C. Winkleman, Shoes; amount of invoice $2,900

   Kohn & Lord, Boys' Clothing; cash paid, $1,975

   Rider-Earl, Furnishings; cash paid $2,835.

5. Paper is purchased from the Eastern Paper Co., for $200

   Fixtures are purchased from Oldfield & Son for $400

6. An auto delivery wagon is purchased from the Auto Exchange Sales Co., for $1,800

8. Sales are as follows:

   R. Souter: Men's Clothing, $600; shoes, $400; furnishings, $800. Cash paid, $1,500

   I. Day: Men's clothing, $750; boys' clothing, $425; shoes, $600

   Cash sales: Furnishhings, $700; shoes, $200

9. Jones, partner, pays in $5,000, as called for by firm agreement

10. Office stationery is purchased for $200, from A. C. Benson & Co.
    Shoes are purchased for $3,000 from O. Sanders & Sons
    Boys' clothing purchases for $3,200 from Samuelson & Loeb
    Brown, partner, pays in $8,000
12. Sales are as follows:
    M. Down: Men's clothing, $800; shoes, $375
    C. Christopher: Boys' clothing, $325; furnishings, $930
    Cash sales: Shoes, $125; boys' clothing, $175
    $150 petty cash fund established. Payments therefrom are:
    Stamps, $25; soap and towels, $20; carfare, $3
13. Bill received for printing circulars and announcements, $80, from James Ruskin
    Bill received for advertising service, from L. Wolf & Co., $1,800
    Office supplies purchased, $10; postage, $15
    Purchase boys' clothing from Marks & Co., $6,000
    Pay Standard Fixture Co., in full, discount taken
15. Sales are as follows:
    M. Dow: Boys' clothing, $800
    C. Smith: Shoes, $2,700
    L. Lane: Boys' clothing, $1,900
    O. Outfitter: Furnishings, $2,100
16. The following payments are made by check:
    Salaries, $400
    Freight inward, $175
    Insurance, $210
    Jones, salary, $150
    Brown, salary, $150
    Cleaning and janitor service, $25
17. Sales are as follows:
    R. Souter: Furnishings, $1,500; men's clothing, $2,500
    I. Day: Boys' clothing, $1,200; men's clothing, $2,500; shoes, $1,000
    Cash sales: Furnishings, $950; shoes, $400
19. Buy of The Mentor Co., furnishings, $1,000

Buy of O. Sanders & Sons, shoes, $2,000
Sell L. Mooney: Men's clothing, $4,000; boys' clothing, $2,000; shoes, $3,500; furnishings, $1,500
Sell L. De Tour, men's clothing, $2,500

20. Sales are as follows:
    R. Snell, men's clothing, $5,000
    C. Smith: Boys' clothing, $500; furnishings, $250
22. R. Souter pays the balance due on his purchase of the 8th.
    Also, he buys the following: Men's clothing, $500; shoes, $400
23. Buy of J. Cohen & Co., boys' clothing, $3,000
    Buy of Rider-Earl, furnishings, $1,700
24. Pay the Eastern Paper Co., $175
    Pay the Auto Exchange Sales Co., $1,600 to apply on the purchase of the 6th
    L. Mooney pays in cash $3,250 and gives a note for $2,000.
    The note is discounted at the bank, discount $20
26. Sell L. Lane: Boys' clothing, $1,500; furnishings, $700;
    Pay $25 for postage
    Brown pays his 30 day note of $10,000
    Pay L. Wolf & Co., $1,000 to apply on account
27. Pay Benson & Co., invoice of the 10th, $200
    Buy $300 worth of furnishings from Rider-Earl, and give them a 30 day note for what you owe them
    Buy of The Mentor Co., furnishings, $1,000
28. Sales are as follows:
    M. Dow: Men's clothing, $1,800; shoes, $200
    C. Christopher: Furnishings, $250
    Cash sales: Furnishings, $450
29. Cleaning and janitor service paid, $15
    Pay for repairs to automobile, $75
31. The following items are paid by check:
    Salaries, $300
    Traveling expenses, $125
    Jones, $125
    Brown, $125

Peerless Garage for care of auto, $30
James Ruskin for invoice of the 13th.
Sell T. Vickery, furnishings, $200
Buy of Chas. Marks & Co.: Men's clothing, $1,500; receive a special discount of 8% for cash in 10 days.

These transactions should all be entered in the books of original entry and be posted completely to the Ledger. Draw a trial balance of the Ledger to see that it is in balance. Which partner is losing by not allowing for interest on investment in the partnership contract? How much does this loss amount to?

CHAPTER VIII

PART 1. PARTNERSHIP ACCOUNTING

§ 172. Partnership Defined

A partnership may be defined in the following manner:

> "A partnership, as between the members thereof, is the association, not incorporated, of two or more persons who have agreed to combine their labor, property and skill or some of them for the purpose of engaging in any lawful trade or business, and sharing the profits and losses as such between them."

Certain basic features of the partnership have already been discussed in the early chapters of the preceding volume. Under the partnership form of organization, it is possible to secure a larger amount of capital than under that of the sole proprietorship. Larger capital means greater business activity. The man with skill combining himself with the man with capital, may make for success in an enterprise, whereas, the two working separately might each be in an undertaking with a poor future.

§ 173. Reasons for Partnership Formation

The reasons for forming partnerships may be set out as follows:

1. To secure additional capital
2. To enlarge scope of business
3. To secure the services of another, because of
    a) Ability, or
    b) Business connections

§ 174. Business and Accounting Viewpoints

The essential operating feature of a partnership is mutual agency, each partner, ordinarily, having an equal voice in management and control. (This is not true, however, in limited partnerships.)

The essential characteristic of a partnership is its limited life; likewise, there is a full debt liability existing against each partner (except in a limited partnership). The relationship between the members of a partnership is a personal one. A partnership cannot be perpetual; death or the retirement of a member automatically dissolves it, even though another man takes the place of the one who has gone. The personal relationship is so intimate in a partnership that all firm members must consent to the admission of any new member.

Legally, a partnership is a collection of individual persons who, in the eye of the law, are treated individually. Suit must be brought against the individuals. (Some states have recently qualified this requirement.) Ordinarily, suit cannot be brought in the firm name. Real property must be held in the name of the individual members, or by one for the others,—as trustee for these others. Every debt incurred by the partnership may, upon proper adjudication, be collected from one of the partners—the one who has money; the private assets of each partner are liable to seizure should the firm assets prove insufficient to pay firm creditors.

The above represents the accounting viewpoint of partnerships; this is in harmony with the legal viewpoint. The business man, however, looks at a partnership as an entity separate and distinct from those who compose it; therefore, unless he is carefully instructed along the lines of securing the correct viewpoint, he may without hesitation precipitate himself into serious difficulties.

§ 175. Partnership a Personal Relation

The partnership relationship is a personal one. One partner may possess certain skill and experience that the others do not; this may be decidedly valuable to the firm. Such skill and experience is as legitimate an investment as any other kind of capital. Sometimes these are considered to be the full equivalent of the money investments of the other members of the firm; again, these may be taken as a partial investment; and again, they may be recognized to the extent that their possessor is given a special salary or percentage of profits.

§ 176. Legal Versus Working Organization

The legal organization, from the above discussion, may be defined as the organization unit which holds property values and directs their use so that they will dovetail harmoniously with the efforts of persons. This organization unit, as was pointed out in the preceding volume, may take one of three forms:

1. Sole proprietorship
2. Partnership
3. Corporation

The working organization is concerned with the internal activities of an enterprise regardless of what may be its form of legal organization. Duties are assigned individuals and responsibilities given them, all of which should be graded according to individual ability, as based upon a careful study and training of each employee. A proper working organization assigns each person his task, without any over-lapping of functions, and without failing to provide for all activities of an essential nature.

§ 177. Classification of Partners

Any person capable of contracting (except a corporation) may, in general, become a partner. Corporations must be authorized specifically by their charters in order to become partners. Since the partnership relation is strictly a contractual one, the parties concerned must be competent to contract. Competent persons are:

1. Minors. A minor may act as an agent. Therefore, his firm acts are binding. He may, however, plead infancy in case of insolvency, and escape the partnership liability, as a whole. But in this connection, under certain conditions, it should be remembered that he may be guilty of a tortious act
2. Partnerships
3. Partnerships and individuals
4. Corporations if expressly authorized

Partners are of many kinds. They may be classified as follows:

1. General (active). A general partner has a part in the firm management, and is liable for the firm's obligations without any amount qualification
2. Limited (special). A special partner has less than full participation in partnership liability
3. Dormant (sleeping). The firm connection of a dormant partner is secret; he has no part in the firm management. All privileges are the result of secrecy. When no longer secret, his liability is the same as that of a general partner
4. Silent. This term does not mean the same as "dormant." A silent partner need not be a secret partner. A dormant partner must be both secret and silent. A silent partner has no voice in the management.
5. Nominal. A nominal partner is a partner in name only. He has no interest in the business or in its profits. He has allowed his name to be used as that of a partner. He is liable only to creditors who know him as a firm member.

6. Sub-partner. A sub-partner is one who shares his firm interest with an outsider. Firm consent is not necessary in this connection. Such a partner is not a member of the original firm, and he is not liable to its creditors. Usually, he has no right of accounting.

§ 178. Classification of Partnerships

Partnerships may be divided as follows:

1. General. This is one formed for the continued prosecution of a general line of business. General partnerships are of two kinds:
   a) Trading. These are formed to buy, sell, and manufacture
   b) Non-trading. These are not formed principally to buy, sell, and manufacture; professional men form them, as brokers, lawyers, etc.
2. Special. This is one formed to carry out some one line of business or to transact one single piece of business. Joint ventures come under this classification
3. Limited. Limited partnerships are formed under special statutes. Some of the members are silent or inactive, with a liability limited to only their investment. When such a special partner becomes active in the business, he becomes a general partner and liable as such. State statutes must be strictly complied with
4. Joint stock company. From the partnership point of view, such an organization is a partnership pure and simple. It usually has a corporate name and some of the features of a corporation. Its members may transfer their interests as do stockholders in a corporation

§ 179. The Partnership Contract

Most partnerships are formed under the rules of the common law, these being the same in every state. In

certain Western states, partnership codes regulate general partnerships. In addition to these laws which govern general partnerships, most states have special statutes for partnerships with special or limited partners.

The only satisfactory method of forming a partnership is by written agreement, this being signed by all parties. This contract may be in the form of a simple memorandum, or it may be a most elaborate document providing for the numerous details and possible exigencies of a large commercial enterprise.

Partnerships frequently are formed by oral agreement. This is very unsatisfactory when a time comes to prove that "such and such" is the actual agreement. An oral contract of partnership to last more than a year is not valid under the Statute of Frauds. Yet, if when the contract is made, the parties enter at once upon its performance, a partnership at will is formed, governed by the contract. Such a partnership may be dissolved at any time by either party no matter what the content of the original contract.

A written or verbal contract at times cannot be proved. In such case, the parties, as between themselves and as to third persons, will be held as partners, if

1. They have acted as partners, intentionally or unintentionally
2. They have a common fund over which a community of interest is exercised
3. They have shared profits and losses

Persons who hold themselves out as incorporated when they are not, may be held as partners, unless they have attempted to incorporate legally and have failed as to some point of procedure. In the latter event, a de facto corporation exists capable of doing business as such.

The usual provisions which should be found in a partnership agreement are as follows:

1. Date partnership to commence, term of existence, and conditions under which it may be terminated before the date originally agreed upon
2. Name of partnership; name of each partner
3. Nature of business to be carried on; principal place of business
4. Amount of each partner's contribution; when and in what form same is to be made; penalty for failure to perform. What value shall be placed on properties contributed, other than cash, and how same shall be disposed of upon dissolution
5. Duties of each partner, especially as regards time and attention to be devoted to partnership business
6. Powers of each partner, especially as to signing checks, notes, contracts, drafts, acceptances, etc.
7. Amount each partner may withdraw; when and in what form he may withdraw. What penalty for excessive drawings
8. Amount of interest to be allowed on capital, and to be charged on drawings
9. How profits shall be distributed, and losses shared. What contingencies may change this apportionment
10. What salaries are to be allowed, if any, and amount of interest to be allowed thereon if same not withdrawn
11. What the proper books of account shall be; by whom shall entries be made therein
12. That books of account and partnership papers be accessible to all partners
13. When accountings are to be made, and what firm of competent accountants shall make the yearly audit
14. How disputes are to be settled
15. What procedure shall be followed in the event of the death or withdrawal of a partner. Shall books

be closed immediately or be kept open for a certain length of time thereafter

16. How life insurance premiums shall be paid, and what the provision shall be in regard to proceeds therefrom

17. Valuation of firm goodwill upon the death or withdrawal of a partner

18. Etc.

Since the partnership relation is a fruitful source of litigation, the partnership articles of agreement should cover every possible contingency. Be protected at every point; too much care cannot be exercised in this particular. Although attorneys-at-law may be competent to pass upon the legal points to be considered and contained in the articles, a competent accountant should be permitted to pass judgment upon the accounting clauses therein to be contained; only infrequently does one find an attorney qualified as an accountant.

§ 180. Firm Name

If two persons form a partnership, both names are used in the firm name, as a rule, the name of the more important partner being set out first. More than two persons may use all the names, a frequent occurrence in professional firms, but not in mercantile firms. In the latter, one or two names will appear, the others being usually represented by "& Co."

If no statute exists to the contrary, any name may be used as a firm name. In some states, if this is done, such name must be registered in the County Clerk's office. The words "& Co." may be required to represent a former or an existing partner. Firm names may be changed at will. More than one name may be used at the same time. Firm business should be done under the firm name, the firm signature being the firm name. All

drafts, acceptances, or securities, should be made out and be taken in the name of the firm.

§ 181. Partnership Property

Partners may contribute as investment:

1. Money
2. Property
    a) Tangible. Tangible property consists of:
        1. Original investment
        2. Profits allowed to remain in the business
        3. Property purchased with partnership funds
    b) Intangible. Intangible property consists of:
        1. Firm name
        2. Goodwill
        3. Trade marks, copyrights, patents

If property is held in the name of one partner, he holds as trustee for the firm. Each partner has an interest in the firm goodwill. Goodwill is discussed in the next chapter. When the business is sold as a whole, the firm name and goodwill are included. Real estate cannot be held by the firm as such. It may be held by the partners as:

1. Tenants in common, or
2. By one member as firm trustee

Real Estate held for the benefit of the firm for partnership purposes is considered to be personal property.

§ 182. Rights and Interests, Powers and Liabilities, of Partners

The rights and interests, powers and liabilities, of partners, under ordinary circumstances, are set out briefly as follows. They should prove useful in understanding partnership activities.

1. Upon dissolution, each partner's investment must be returned to him in full if the assets are sufficient in amount to do so

2. Remaining property should then be divided in equal portions

3. Losses should be shared equally unless agreement states to the contrary. Losses diminish investment

4. Interest is paid on investment only when agreed to in the partnership contract

5. Each partner may loan money to the firm. Such loan does not become part of the investment. It must be repaid to the partner so loaning before the capital invested is returned

6. Surviving partners have right of possession of firm property to settle affairs. This done, each has a right therein only in proportion to his capital

7. No one partner has power over partnership property greater than that of each other partner. Each is an agent of the others in relation thereto

8. Personal property may be bought or sold by each partner, his acts binding the others. Property used to carry on the business is not included in the above, because to do so may destroy the business. In such case, all partners should agree to such transaction

9. A contract to convey realty may be made by a partner if within the scope of the business. But he cannot convey if the realty is held in the name of another partner. A contract to purchase realty may be valid if made by a partner within the scope of the business

10. Realty purchased for sales purposes is personalty

11. For partnership purposes, a partner may mortgage or pledge firm property

12. Each partner's interest can be reached by attachment or execution. This interest is a right to a certain portion of the surplus after debts are paid and partnership affairs are adjusted. A purchase under execution dissolves a partnership

13. Assignment for benefit of creditors can be made only by all partners acting together. If one partner makes assignment, others may ratify it. If one partner cannot be found, remaining partners may make valid assignment. The New York laws permit one partner to assign for the benefit of a creditor. When an assignment has been made, any creditor can bring bankruptcy proceedings

14. Profits should be defined in the partnership agreement. Sharing profits is an essential feature and the usual object of a partnership. Profits are shared equally unless contract specifies otherwise

15. Salaries for services and interest on investment should be set out in the partnership contract

16. Profits made within the scope of the partnership business belong to the firm. A partner using firm money for personal uses, must account to the firm for profits made. In such case, losses must be borne by the individual partner

17. Each partner has the right to demand that accurate accounts be kept. Each partner must furnish the information permitting this to be done. Books of account should be kept in the firm office

18. Each partner has equal authority with the others, and is bound by the acts, contracts, and frauds of the others committed within the scope of the business

19. Notes may be made and be indorsed by each partner in the firm name. If the payee does not know that a fraud has been committed, in this connection, he can hold the firm on a fraudulent note. Notes are not usually given in a non-trading partnership, except upon specific authorization or because doing so is in accordance with usage

20. Restrictions on the powers of partners do not bind third persons unless the latter have them brought to their attention

21. The majority rules in a partnership. When evenly divided, a proposed change will not stand. No change can be made in the partnership agreement except by unanimous consent of all partners

22. If a single partner, due to his agency powers, commits an act that the others do not concur in, the only remedy is to dissolve

23. No partner can secure an advantage for himself at the expense of the others

24. Non-competing ventures may take part of a partner's time. Competing ventures he must not engage in. The partnership agreement should cover the point of a partner having outside interests

25. A partner can retire at any time. Local laws must be examined carefully in this connection

26. A partner is liable in damages for the injuries, frauds and wrongdoing of one of the other partners if done within the scope of the partnership business; usually, he will not be held criminally liable

27. In order to enforce partnership liability, third persons, usually, must prove the existence of a partnership

§ 183. Partnership Problems

The accounting problems peculiar to partnerships offer no principles essentially new. However, the application of these principles requires a more complete knowledge of details and more accurate and logical reasoning in order to secure equitable results than does any other branch of accounting. Most partnership problems require more mathematical ability, and abstract reasoning power, than a technical accounting training. Most of the problems may be solved even if one does not fully understand the meaning of debit and credit.

In the solving of these problems, a knowledge of general partnership law is absolutely essential. This is the reason for including so much law in the present discussion.

The partnership problems confronting the student and business man group themselves roughly about as follows:

- A. Formation of a new firm
  - 1. Simple opening
    - a) Partners introduce definite and fixed amounts of capital
    - b) Partners introduce indefinite and fluctuating amounts of capital
  - 2. Single proprietorship converted to a partnership
  - 3. Admission of a new partner
    - a) Buying an interest
    - b) Making an investment to secure an interest
    - c) Partnership consolidation
- B. Operation of the partnership
  - 1. Division of profits and losses
    - a) Based upon amounts of capital originally contributed
    - b) Based upon amounts of capital originally contributed and accumulated
    - c) Based upon amounts of capital contributed and length of time employed
    - d) Based upon a ratio different from the capital ratio
  - 2. Interest on capital
    - a) Three ways of adjustment
  - 3. Interest on partners' loans
  - 4. Partners' life insurance
- C. Dissolution, termination, and liquidation
  - 1. Sale or transfer to another business
  - 2. Dissolution agreed upon or enforced
  - 3. Installment distribution upon dissolution

A slight overlapping in explanation will be noticed in the discussion of the above points, but this is necessary to make the discussion of each part as complete as possible On the whole, however, the above is a fairly adequate summary of partnership problems.

§ 184. Partnership Accounts Versus Accounts of a Sole Proprietor

The principles underlying the operation of the accounts of a partnership business do not differ fundamentally from those underlying the same type of business owned and conducted by one person. The difference in partnership accounts over those of a sole trader occurs in connection with the proprietorship accounts. This difference is:

1. More than one capital account
2. Withdrawal accounts

This difference is due to the difference existing between a partnership organization and the organization of a sole trader's enterprise. It crops out in the opening entries, and in the closing entries at the end of a fiscal period.

The capital account of a sole trader represents ownership. The sole trader receives all profits and suffers all losses. In a partnership, the capital is not contributed solely by one man; also, one man does not receive all the profits and he does not suffer all the losses. Therefore, in the partnership, there must be an investment account for each partner in order that each partner's net equity in the net assets may be stated properly. The Journal, as the book of original entry recording the partnership opening, should show the share and the contributions of each partner; careful record should be kept of all subsequent additions in cash or in property.

A withdrawal account should be kept for each partner. This is an account subordinate to the Capital account, in which is kept a record of the partners' withdrawals. At the end of the year, its balance must be taken into consideration when figuring the amount of the proprietorship. The purpose of such an account is to keep the small and

perhaps numerous items out of the Capital account during each period, the latter representing actual investment in the business.

The division of the net profits at the end of the fiscal period is governed by the copartnership articles, and the capital accounts at the end of each period should reflect the status of each of the firm members. Before the distribution of net profits is made, adjustments, usually, are necessary on account of such factors as the amount of time each partner invests in the business, the ability of one partner as compared with another, and the fact that one partner has contributed more capital, perhaps, than another, or the fact that he may have loaned money to the firm.

Questions arising hereunder are usually more theoretical than practical. The method used to show the respective interests of the partners in the concern should reflect the terms of the copartnership agreement and should present a clear analysis of the exact relations existing between them. This is best accomplished by opening such ledger accounts with each partner as may be necessary to make clear such a relationship; and to this end, all or certain of the following accounts may be adopted. Their functions, likewise, are indicated below.

Capital or Investment Account

Dr.	Cr.
With amounts drawn where purpose is to reduce the investment	With original investment, and with all additions thereto

The balance of this account should be, ordinarily, a credit, indicating the net investment of the partner, excluding any increases due to profits, salary allowances, interest on capital, etc.

PERSONAL, DRAWING OR CURRENT ACCOUNT

Dr.	Cr.
With temporary withdrawals of capital,—exclusive of salary, interest charged on drawings, share of net loss	With temporary investments, interest on capital, share of net profits

The balance, if a credit, indicates net increase in partner's net worth due to the items herein recorded; it may be shown in the balance sheet under Capital.

A debit balance indicates capital impairment, and on the balance sheet may be deducted from the capital account

If it is the intention to consider the balance of this account either as a permanent addition or deduction from capital, such balance eventually is closed into the capital account

SALARY ACCOUNT

Dr.	Cr.
With drawings against salary allowance	Monthly with the salary allowance as set out in the partnership agreement; the debit offsetting this credit would be to the account of Partners' Salaries

The balance, if a credit, indicates undrawn salary; if the balance is a debit, it shows amount of salary overdrawn.

On the balance sheet, the balance of this account may be set out under the capital section. Again, if a credit balance, it may be set out as a liability; and if a debit balance, as an asset. The second method is permissible since the balance represents an interest somewhat apart from the partnership interest.

While the distinction between each of these three accounts—capital, personal, and salary—is more or less theoretical, nevertheless, if each account is carefully kept, there will be no occasion for misunderstanding in regard to the division of net profits at the end of the year.

LOAN ACCOUNT

Dr.	Cr.
With the repayment of part or all of the loan made	With any loan made by the partner which is not to be considered as an increase in his investment Unpaid interest upon such loan may be credited to this account

The balance, always a credit, is shown among the firm liabilities. When a partnership is being wound up, such a loan is to be repaid after outside creditors have been satisfied, but before the partners' capitals are returned

§ 185. Partner's Interest in Partnership

At any time, a partner's capital interest is represented by his investment less his drawings, plus his share of the profits or minus his share of the losses. Care must be observed in distinguishing between division of profits and a share in the partnership assets. Profits are divided in accordance with the terms of the partnership contract, and if the contract is silent on this point, the division will be in equal proportions. A partner's share in the partnership assets is determined by his Capital account,—the latter in connection with his drawing account if he has one.

Each partner's rights, from an accounting viewpoint, are seen to relate to two principal things:

1. Partnership capital
2. Partnership profits

§ 186. Opening Entry for Partnership

The problems in connection with the simple formation of a partnership are elementary in nature. They may be set out as:

1. Capital contributions definite and fixed
2. Capital contributions indefinite and fluctuating

§ 187. Capital Contributions Definite and Fixed

Partnership investments may consist of:

1. Cash
2. Cash and other property

The two following simple illustrations suffice:

Problem 1. J. Doe and H. Roe form a partnership to conduct a general merchandising business, each investing cash, $10,000.

Solution. All opening entries should be made complete in the Journal. The cash transactions, of necessity, will be checked off therein and be transferred to the Cash Book, from which place they will be posted eventually to the Cash account in the Ledger.

> A partnership was formed this ...... day of ......, 19.., between J. Doe and H. Roe for the purpose of conducting a general merchandising business, location to be at ...., each one investing cash $10,000. The business is to be operated under the firm name of ...., and the profits and losses are to be shared ....

Two methods exist for recording these facts. The first method is advised by many accountants in view of the fact that it reflects the deficiency, in an account upon the books, in the capital contributions as made as compared to the agreement in force. The second method is the usual one encountered in practice.

Method No. 1.

1)	J. Doe, Current Account........	$10,000.00	
	H. Roe,—Current Account......	10,000.00	
	To—J. Doe—Capital Account.		$10,000.00
	H. Roe—Capital Account.		10,000.00

To charge each partner for the amount of his agreed contribution and to credit each partner's capital account therefor.

2) When the cash is paid in, the entry, in Journal form, would be:

Cash	$20,000	
To—J. Doe—Current Account.		$10,000.00
H. Roe—Current Account.		10,000.00

To record cash investment made this day in full.

Method No 2.

Cash	$20,000.00	
To—J. Doe—Capital Account.		$10,000.00
H. Roe—Capital Account.		10,000.00

To record investment made upon this day.

Problem 2. A. Doe and J. Moe form a partnership for the purpose of conducting a small manufacturing business. A. Doe invests accounts receivable, $10,000, notes receivable $5,000, with accrued interest of $50, machinery and tools, $4,000, materials, $20,000, land, $5,000, and building, $6,000. The liabilities to be assumed are accounts payable, $8,000, notes payable, $3,000. J. Moe invests cash, $39,050. Profits or losses are to be shared equally.

Solution. The opening entry would be as follows:

> A partnership was formed this .... day of ...., 19.., by and between A. Doe and J. Moe for the purpose of conducting a small manufacturing business, located at .... The firm name of the partnership is to be .... Profits or losses are to be shared equally.

The investment entries are as follows:

Method No. 1.

1) A. Doe, Current Account........	$39,050.00	
J. Moe, Current Account........	39,050.00	
To—A. Doe, Capital Account..		$39,050.00
J. Moe, Capital Account..		39,050.00
2) Accounts Receivable (Itemized or referred to in list on file)..	10,000.00	
Notes Receivable (Itemized with full particulars)	5,000.00	

Accrued Interest on Notes Receivable	50.00	
Materials	20,000.00	
Machinery and Tools	4,000.00	
Building	6,000.00	
Land	5,000.00	
To—Accounts Payable (Itemized or referred to in list on file)		8,000.00
Notes Payable (Itemized with full particulars)		3,000.00
A. Doe, Current Account		39,050.00

To record properties turned over by A. Doe in full payment of his capital contribution.

Cash	$39,050.00	
To—J. Moe, Current Account.		39,050.00

To record cash paid by Moe in full payment of his capital contribution.

Under this method, if Doe had failed to put in the amount of capital which he had agreed to contribute, his Current account would indicate that fact. If he had agreed to contribute a certain amount of capital, and fails to do so, it is just that he should be charged interest upon the amount of the deficiency. By the above method, this deficiency will appear upon the books of account.

Method No. 2

Accounts Receivable (Itemize)	$10,000.00	
Notes Receivable (Itemize)	5,000.00	
Accrued Interest on Notes Rec.	50.00	
Materials	20,000.00	
Machinery and Tools	4,000.00	
Building	6,000.00	
Land	5,000.00	
To—Accounts Payable (Itemize)		$ 8,000.00
Notes Payable (Itemize)		3,000.00
A. Doe, Capital		39,050.00
To record investment of A. Doe		
Cash (See Cash Book)	$39,050.00	
To—J. Moe, Capital		$39,050.00
To record investment of J. Moe.		

§ 188. Contributions Indefinite and Fluctuating

The capital contributions to a partnership may be indefinite and fluctuating as well as definite and fixed. The agreement should specifically cover such a condition.

Problem. John Jones enters into partnership with

S. Brown. John Jones is to invest accounts receivable $15,000. His capital is to be the amount these accounts will bring when collected. $12,000 eventually was collected, $3,000 of them proving to be worthless. Make the proper entries to record the investment of John Jones.

Solution.

1) Accounts Receivable...........	$15,000.00	
To—John Jones, Capital Suspense		$15,000.00
To record contingent contribution		
2) Cash (See Cash Book).........	12,000.00	
To—Accounts Receivable		12,000.00
To record collections		
3) John Jones, Capital Suspense...	12,000.00	
To—John Jones, Capital......		12,000.00
To credit Jones with definite amount of capital per collections received.		
4) John Jones, Capital Suspense...	3,000.00	
To—Accounts Receivable		3,000.00
To close		

Part 2. Bookkeeping Review

The following transactions are a continuation of the work set forth in the last chapter for the month of January. Use the same records as before, with the exception of the Cash Book. A new Cash Book should be ruled, the ruling being similar to that of the former one. Enter the new transactions as occurring in the month of February.

2. Jones and Brown agree to sell, and Smith agrees to purchase, a one-fourth interest in the firm of Jones and Brown. In the new firm, the capital interests of the partners shall be in the ratio of Jones, one-fourth; Brown, one-half; Smith, one-fourth. Profits are to be shared in this proportion, which is: Jones, 25%, Brown, 50%, and Smith, 25%. The basis of calculating the worth of Jones and Brown shall be a balance sheet prepared as of the close of business, January 31, and in this connection all partners agree to the following:

   a) The accounts receivable are to be valued

as shown on the books less a reserve of $2\frac{1}{2}\%$ for bad debts

b) The automobile is to be valued at cost, less a reserve for depreciation of 30% per annum

c) The furniture and fixtures are to be valued at cost, less a reserve for depreciation of 10% per annum

d) $60 a month is to be reserved for taxes

e) The payroll of the firm of Smith & Brown for January 30 and 31 amounts to $48

f) A freight bill is outstanding against the old firm in the amount of $54

g) Merchandise on hand is to be valued as follows:

Men's clothing	$10,030
Boys' clothing	9,075
Shoes	9,050
Furnishings	13,000

h) Paper stock is valued at $110; stationery, $75

i) The new firm assumes all the liabilities

The new firm is to be known as Jones, Brown & Smith. Smith pays his investment into the firm in cash. Jones and Brown are paid in cash for their share of the partnership interest sold Smith

3. Purchases:
   J. Cohen & Co., boys' cothing, $2,800
   Johnson Co., shoes, $2,300
   Rider-Earl, furnishings, $3,800

   L. Lane pays $2,500 on account, discount 6%
4. Pay freight bill outstanding

   Sales: I. Day, furnishings, $710; shoes, $800
   O. Outfitter, furnishings, $790
5. Return to Johnson Co., shoes, $420

   I. Day pays cash, $5,800 on account, being allowed 5% discount

   Pay Smith Duggan, $500
6. Sales: L. De Tour, boys' clothing, $1,600; shoes, $900

Receive cash from L. Mooney, $4,000, allowing 5% discount
C. Smith returns furnishings, $105
Pay Chas. Marks, $3,000
Cash sales: Men's clothing, $2,200
7. M. Dow pays cash for what he owes you, being allowed 5% discount
Pay Mentor Co., $800
Pay O. Sanders & Son, $1,600
Replenish petty cash fund
Pay for stationery supplies, cash $12
9. Pay for cleaning and janitor service, $24
Sales: T. Vickery, furnishings, $700; men's cloth-clothing, $2,600; boys' clothing, $800
R. Snell, shoes, $1,100
Cash sales: furnishings, $600; boys' clothing, $300
10. Pay Chas. Marks & Co., cash for remainder of first bill of goods secured from them; no discount. Also, pay them for the second purchase made; discount 5%
11. C. Christopher pays his account in full, being allowed a discount of 5%
Receive check in full from L. De Tour, discount 5%
12. Purchases: Johnson Co., shoes, $1,050
Oldfield & Son, furnishings, $1,325
13. Sales: C. Duncan, furnishings, $900; boys' clothing, $600
K. Jones, men's clothing, $3,200; shoes, $1,900
Pay freight, $65; postage, $20; wages, $290; traveling expenses, $140
Jones draws $200; Brown draws $175; Smith draws $75
16. Sales: C. Smith, furnishings, $350; men's clothing, $1,980
L. Lane, boys' clothing, $375; shoes, $930; boys' clothing, $250. He encloses check in full of account, not including the above, taking a discount of 5%
17. Buy of Samuelson & Loeb, men's clothing, $3,800

Buy of O. Sanders & Son, furnishings, $2,800
Pay Auto Exchange Sales Co., balance due
Pay L. Wolf & Co., balance due

18. C. Smith pays $5,000, taking a 5% discount
    Pay Samuelson & Loeb, $3,500 on account, receiving 6% discount
    Pay The Mentor Co., $2,000 on account, discount 6%
    Cash sales: Shoes, $740; boys' clothing, $1,020; men's clothing, $785
19. I. Day pays his bill, taking a discount of 5%
    Sell M. Dow, men's clothing, $2,200
    Sell L. De Tour, furnishings, $400
    Pay insurance, $625
    Pay E. Paper Co., balance due
20. Buy of the Co-op Stationery Co., stationery, $125
    Receive on account from T. Vickery, $3,300; discount 5%
    Receive on account from R. Souter, $350
    O. Outfitter pays cash in full for the first purchase made by him, discount 5%
21. I. Day buys furnishings, $980; men's clothing, $2,700; boys' clothing, $1,300
23. Sales: H. Bunte, men's clothing, $1,600; shoes, $1,050
    C. Smith, boys' clothing, 1,400; furnishings,
    Purchases
    J. Cohen & Co., boys' clothing, $4,600
    Johnson Co., furnishings, $5,200
    Send J. Cohen & Co., check to cover bills of prior standing, taking a discount of 6%
24. Cash sales: Shoes, $800; men's clothing, $1,125
25. Buy car tickets, $6; sundry expenses, $12
    Brown pays his notes in cash
26. Jones takes clothing for himself, $150; furnishings, $25
    Pay wages, $220; traveling expenses, $100; garage bill, $35
    Sell L. Mooney, men's clothing, $6,500
    Pay Johnson & Co., in full, discount 6%
27. Pay James Ruskin balance due

Jones draws $150; Brown draws $150; Smith draws $130
Pay office salaries, $90
Sell L. Lane boys' clothing, $1,300; shoes, $600
O. Outfitter pays his bill, discount 7%
Purchase of Oldfield & Son, furnishings, $890

28. Pay J. Cohen & Co., $5,000, taking discount of 6% only on the amount paid against the third order placed ($2,800)
Drawings: Jones, $50; Brown, $50; Smith, $45
Return goods to Johnson & Co., furnishings, $800

Post and close the books of the firm of Jones, Brown & Smith, giving attention to the following:

Inventories:
- Furnishings, $17,300
- Men's clothing, $26,100
- Boys' clothing, $14,050
- Shoes, $11,400

Payroll unpaid for February, $80
Deferred charges:
- Insurance, $650
- Advertising, $500
- Stationery, $40
- Rent, $1,250

Reserves, as for January

Prepare balance sheet and relative statement of profits and income.

CHAPTER IX

PARTNERSHIP ACCOUNTING (Continued)

§ 189. Capital Contributions

The real capital of a partnership, its accounting capital, is the excess of its assets over its liabilities. The principal capital fund is secured by contribution, each partner, when he becomes such, usually putting a certain amount of capital into the business by way of investment. However, it should be noticed that there are other sources from which capital may come. Briefly, they may be outlined about as follows:

1. Original investments plus additional contributions thereto
2. Net profits transferred to Capital accounts at the end of a fiscal period; the undrawn profits added to investment
3. Investment by new partner upon his admission to membership in the firm
4. Loans
    - a) By partners
        - i. Temporary
        - ii. Long time
    - b) By outsiders
        - i. Temporary
        - ii. Long time

The partnership agreement should cover these contingencies; if not, a revision of the agreement is necessary.

The following problems arise in connection with original contributions:

1. The partnership agreement may be silent as to the exact amount of capital each partner shall invest. Property may be taken by agreement in lieu of money. The agreement may state that the exact amount of cash contribution depends upon what valuation is given to the property taken over. When all is completed, the original investment may be in excess of needs

2. One partner may not have enough funds to meet his calls, whereas, another may introduce more than he is required to do.

Net profits at the close of a fiscal period may be transferred to the partners' Capital accounts, to be left in the business. If left in the business, these increase the firm's working capital. Profit additions may be considered either as loans to the business or as additions to the original investment. The amount of profit left is different usually for each partner. When added to the original contributions, this difference disturbs the original ratio existing between the partners' original capital. Because of this fact, when profits are shared on the basis of investments, the profit sharing ratio should be adjusted periodically so that the actual investments correspond thereto.

Profits left in the business may draw interest, interest being allowed on all contributions above the original investments. The partnership agreement should cover this point favorably so that there will be an inducement to the partners to leave profits in the business. Such practice will perhaps reduce outside borrowings to a minimum.

Capital accretions due to profits, upon dissolution of the firm, may constitute claims against the enterprise outranking (having priority over) the capitals in the order of being liquidated; that is if they partake of the nature of loans. If so, they should be carried in a "Loan" account, to be left open on the books and not periodically closed into a Capital account.

When partners contribute funds, it should be agreed upon specifically whether they are to be considered as additional capital or as loans to the firm. Ordinarily, they will be regarded as a loan.

1. If capital. Show them in the Capital accounts. The profit sharing ratio should be affected equitably by such procedure, although it may not be
2. If loans. Enter them in the partners' Loan accounts, and not to the Capital or Drawing accounts. Upon dissolution, trade creditors' claims must be satisfied first, then a loan made by a partner will be paid with interest which has accrued thereon and, lastly, the assets remaining for distribution will be divided among the partners as called for proportionately by the balances shown in their Capital accounts. Loan interest, if not credited to Cash but credited to the partner, should be credited to his Loan account, and not to his Capital or Drawing account
3. Loans may be evidenced by firm notes signed by all the partners and given to those making the loan. These notes are not regular notes payable,—they do not represent liabilities to outsiders. Ordinarily, the latter must be met promptly according to the terms of the instrument. At common law, a partner cannot bring suit against the partnership of which he is a member.
    a) Partner's Notes Payable account. Records a loan evidenced by a note
    b) Partner's Loan account. Records a loan not evidenced by a note

Funds may be borrowed from the outside, if

1. Partners cannot loan to the business, or
2. A new partner is not desirable

Loans of this character are usually long-time loans. They should not be placed in the regular Notes Payable account, but in a separate Notes Payable account (or per-

haps in a Mortgage Loan account). Such loans may be for

1. Current purposes. Required because customers are slow pay, or because turnover of stock is slow
2. Permanent capital. Required because original investment is not sufficient to meet present conditions

Loans by partners may affect the credit of a partnership in either one of two ways:

1. Favorably. If the firm is in good standing in the community, the fact that the partners have put in more capital is an evidence of prosperity, which will help to increase the credit of the firm
2. Unfavorably. If the firm is not in good standing, such loan may be looked upon with suspicion, since it may be made to attract outside credit. After having done so, the loaning partner may withdraw his loan before outsiders discover any real trouble. If the loaning partner is secured by demand notes, these may be presented by him upon maturity, and if unpaid, he may demand an accounting, thereby forcing the firm into dissolution. It may then be possible for him to buy out the interests of the others at a low price,—a case of crooked finance.

§ 190. Single Proprietorship to Partnership

The following problem illustrates the case of a sole trader admitting another into partnership with him, the other bringing in an additional investment.

Problem. The following trial balance was taken from the books of A. Slocum who has formed a partnership with W. Winters:

Cash	$ 2,100
Accounts receivable	15,500
Notes receivable	2,700
Merchandise inventory	37,500
Machinery and tools	12,000
Buildings	13,000
Land	12,000

Accounts payable		$12,200
Notes payable		6,000
A. Slocum, capital..................		76,600
	$94,800	$94,800

Required:

a) Entries to record transfer of the assets and liabilities of the business of A. Slocum to the firm of Slocum & Winters

b) Entries to open the books of the new firm

Solution. The entries to record the transfer of the assets and liabilities of the business of A. Slocum to the firm of Slocum & Winters, upon the books of A. Slocum, are as follows:

1) Slocum & Winters..................	$94,800	
To—Cash		$ 2,100
Accounts receivable...........		15,500
Notes receivable		2,700
Merchandise inventory.........		37,500
Machinery and tools..........		12,000
Buildings		13,000
Land		12,000
To record the transfer to the firm of Slocum & Winters of the above assets as per agreement under date of................		
2) Accounts payable	$12,200	
Notes payable......................	6,000	
To—Slocum & Winters............		$18,200
To record the liabilities that are to be assumed by the firm of Slocum & Winters under agreement dated....................		
3) A. Slocum, capital..................	$76,600	
To—Slocum & Winters............		$76,600
To close the books of A. Slocum he having received in the new firm of Slocum & Winters an interest in the amount of the above		

The entries to open the books of the new firm of Slocum & Winters are as follows:

1) Cash	$ 2,100	
Accounts receivable	15,500	
Notes receivable	2,700	
Merchandise inventory	37,500	
Machinery and tools	12,000	
Buildings	13,000	
Land	12,000	
To—A. Slocum, capital		$94,800
To record the assets secured from A. Slocum as per agreement under date of............		

2) A. Slocum, capital	$18,200	
To—Accounts payable		$12,200
Notes payable		6,000
To record the liabilities of A. Slocum assumed and taken over under agreement dated........		

§ 191. Goodwill

Goodwill may be defined in a number of ways. The two following definitions will suffice:

> "It is that peculiar power of attraction whereby the proprietor causes the buyer to seek him or his place of business when in the market for the kind of goods which the proprietor has for sale."
>
> "The value of the benefits or advantages which attach to a particular business, in addition to the actual value of the property used in its conduct."

Goodwill is more to be considered, perhaps, in connection with corporate affairs than with partnerships. Therefore, the subject will not be treated in full at present.

Goodwill is a thing to be acquired, and not to be created by a book entry. It should be something to be defined, but in many cases it represents merely the difference between the true value of assets taken over and the value which has been placed upon them.

Goodwill is an intangible fixed asset. Its value is problematical, the task of valuing it being a difficult one. Three possible times arise when a value should be placed

upon this "benefit arising from the connection and reputation of the firm":

1. When it is desired to reduce the rate of return upon capital investment
2. When it is desired to dispose of it by sale or consolidation
3. When it is desired to place a value upon it in an established business before a new partner is admitted

Therefore, it is seen that in relation to a partnership, goodwill is of importance in the following connections:

1. When a new partner is to be admitted
2. When a partnership business is to be sold
3. When a partner dies or leaves the firm

When a new partner is to be admitted, the former partners may wish to place the item of goodwill upon their books. When a business is sold, its goodwill passes with the sale of the concern as a whole to the vendee, even though the contract of sale may not so specify. The partnership agreement should carefully cover the matter of goodwill; otherwise, it may be decided that an outgoing partner is not entitled to anything for his share thereof.

When a business purchases the goodwill of another concern, the goodwill so purchased is a legitimate asset. The value paid therefor may then be carried on the books as a permanent asset, not subject to depreciation or extinguishment. Prosperous firms, in many cases, will write off this asset, on account of its questionable actual value, over a period of, say, from three to five years. The value of goodwill, in any case, will be reflected in increased earnings; therefore, if a concern is prosperous, its goodwill has worth, whereas, if it is not prosperous, its value is entirely problematical. If a concern is not

prosperous, the goodwill may be absolutely without value regardless of the price that has been paid therefor.

Ordinarily, goodwill is appraised as equaling a certain number of years' average profits,—net profit reduced by an arbitrary rate per cent. on the capital invested.

The following problems present the handling of the item of goodwill.

Problem 1. Where goodwill is to be set up in the accounts. A, a sole trader, has assets amounting to $10,000. He takes B into partnership with him, B investing $10,000, and agreeing that A's goodwill is to be valued at $5,000.

Solution. The solution to the above problem is shown in the following accounts, after all entries are posted.

Assets (Excluding Goodwill)		A—Capital	
Balance	$10,000	Investment	$10,000
Cash (B)	10,000	Goodwill	5,000
Goodwill		B—Capital	
A—Capital	$ 5,000	Investment	$10,000

Problem 1a. The accounts are as above at the close of a period. A and B sell their business for $30,000, receiving $20,000 for the assets and $10,000 for the goodwill. Adjust the accounts given above to meet these conditions. Profits are shared equally.

Solution. Journal entries show the solution as follows:

1) Vendee	$30,000	
To—Assets (excluding goodwill)		$20,000
Goodwill		10,000
2) Goodwill	5,000	
To—Profit and loss		5,000
3) Profit and loss	5,000	
To—A, capital		2,500
B, capital		2,500

A's profit on goodwill would be $7,500, as his account was credited with $5,000 previously for goodwill.

If the goodwill realized:

1. $5,000, the amount charged to the account, there would be no profit or loss 'due to the sale

2. $3,000, the firm would lose $2,000, chargeable equally to the partners. A would have profited entirely to the extent of $4,000, and B would lose $1,000
3. Nothing, A's profit would be $2,500, and B's loss $2,500

Problem 1b. The partners agree to write off the goodwill over a period of years. The goodwill has been written off. Subsequently, it realized $10,000, $5,000 more than in the first instance. Show the result.

Solution. In the absence of an agreement, goodwill written off would be chargeable against all the partners proportionately. When the goodwill realized $10,000, the Goodwill account would be credited, although the actual profit on goodwill to the firm was only $5,000, the previous years' reductions being overstated to the extent of such charges.

Problem 2. When goodwill is not to be set up in the accounts. The facts are the same as in problem 1. Goodwill is to be valued at $5,000. B invests $10,000, and pays A for the goodwill in cash, no entry to be passed through the books.

Solution. The solution need hardly be set out; it is self-evident. The accounts are as follows:

Assets		A—Capital	
Balance	$10,000	Investment	$10,000
Cash (B)	10,000	B—Capital	
		Investment	10,000

Such an agreement has the effect of insuring to A the full realization of the amount. If A's Capital account were credited with the amount of the goodwill, and the Goodwill account debited, the eventual realization of the item in cash would be uncertain, as was shown above in 1a. If the business were sold later, $5,000 being received for the goodwill, the amount received therefor would be divided between the partners the same as other profits.

Problem 3. Jones has assets of $120,000, and liabilities of $40,000. He sells his business for $100,000. Pro-

duce the balance sheet of the vendee just after the sale agreement has been consummated.

Solution.

Balance Sheet

Various Assets	$120,000	Various Liabilities	$ 40,000
Goodwill	20,000	Jones, Capital	100,000
	$140,000		$140,000

When Jones is paid, his Capital account would be charged, and the Cash account credited, after the various asset and liability accounts had been closed into a Vendee's account and this latter closed by a charge to the Cash account.

Under the above conditions, Jones, the vendor, could operate the records in one of two ways:

1. Set up a Goodwill account to bring his books into accord with the offer of sale. This has been done in the above solution
2. Set up a Realization and Liquidation account. This account will be discussed more completely at a later time. The asset accounts are closed by being debited to this account, and the liability accounts are closed by being credited to this account. The sales price would then be credited to the account being offset by a charge to the Vendee's account. The Realization and Liquidation account now holds a credit balance amounting to $20,000, representing profit. This amount is then transferred to the Capital account of Jones. This Capital account, at this point, contains a credit balance offset by the debit balance in the Vendee's account. When cash is received, the Vendee's account is credited. When the cash is withdrawn, all accounts will be closed.

§ 192. Admission of a Partner

There are two conditions under which a person may be admitted as a partner in an enterprise:

1. Where the contribution does not increase the business capital

2. Where the contribution does increase the business capital

Under the first condition, the incoming partner *purchases* a certain interest in the business from the owner or owners. The amount paid for this interest thus acquired goes to those from whom it was purchased, there being no increase in the total capital of the enterprise. The transaction is one of a personal nature between the present owner or owners and the outside party,—the purchaser.

Under the second condition, the incoming partner makes an *investment* or *contribution* of such an amount as is agreed upon to acquire a stated share in the business enterprise. The investment, when made, becomes the common property of all the owners of whom the new partner is one. This condition presents a two-way possibility:

1. Profits and losses shared in proportion to capital ratios
2. Profits and losses not shared in proportion to the capital ratios

These two basic conditions are discussed in the next three sections of this chapter.

§ 193. Buying an Interest in a Business

As mentioned above, care must be observed in distinguishing between buying an interest in a business and making an investment to secure a share in a business. The following problem illustrates the first possibility.

Problem. Brown is the proprietor of a business. His books were closed on December 31, 1919, at which time his prepared balance sheet was as follows:

Balance Sheet of Brown

Sundry Assets	$ 38,000	Brown, Capital	$ 38,000

Brown offers to sell Jones a one-third interest in his business for $30,000, based upon the above balance sheet. Jones accepts the offer. How would the Capital accounts then stand?

Solution. The sale of a one-third interest for $30,000, is equivalent to valuing the business at $90,000. Therefore, it is evident that Brown is selling Jones something besides tangible assets; in other words, goodwill. Since the books show Brown's net capital to be $38,000, the excess, or goodwill, must be introduced thereon. When done by the Journal entry of:

Goodwill	$52,000	
To—Brown, Capital		$52,000

the result upon the Balance Sheet above is seen to be as follows:

Balance Sheet of Brown

Sundry Assets ....$	38,000	Brown, Capital ......$	90,000
Goodwill	52,000		
	$90,000		$ 90,000

Since Jones is buying a one-third interest in the business of Brown, the amount Jones pays therefor has nothing to do at all with the books of account of the business; it is a private matter between the two men. The payment by Jones will not be entered upon the books. The entry upon the business records will be:

Brown, Capital	$30,000	
To—Jones, Capital		$30,000

The result upon the Balance Sheet of the new firm will be:

Balance Sheet
Brown & Jones

Sundry Assets ....$	38,000	Brown, Capital ......$	60,000
Goodwill	52,000	Jones, Capital	30,000
	$ 90,000		$ 90,000

The asset item of goodwill might have been eliminated entirely from consideration, in which event the Balance Sheet of the new firm would be as follows:

Balance Sheet
Brown & Jones

Sundry Assets	$38,000.00	Brown, Capital	$25,333.33
		Jones, Capital	12,666.67
	$38,000.00		$38,000.00

By either method of solution followed, the relation existing between the interests of Brown and Jones in the business is Brown 2/3, and Jones, 1/3; this is in agreement with the partnership contract.

In this problem there has been merely a sale by Brown of a share in his business, which has resulted in a division of his interest. Jones introduced no cash at all —he made no investment.

§ 194. Making an Investment to Obtain a Share in a Business

Problem. Suppose, on the other hand, in the problem above, the agreement stated that Jones was to come into the business and secure a one-third interest therein by making an investment of $30,000. How would the Capital accounts stand?

Solution. The case here is entirely different from the preceding one. The opening Balance Sheet of the new firm would appear as follows:

Balance Sheet
Brown & Jones

Sundry Assets	$ 38,000	Brown, Capital	$ 60,000
Goodwill	22,000	Jones, Capital	30,000
Cash	30,000		
	$ 90,000		$ 90,000

In this event, where a one-third interest is acquired, a valuation of $90,000 again is placed upon the business as

a whole. Therefore, a Goodwill account in the amount of \$22,000 would have to be set up on the books.

Again, if the asset of goodwill is not considered, as might be the case, after entering the cash invested by Jones, the assets would be thereby raised to \$68,000, in which Brown has a 2/3 interest, and Jones a 1/3 interest. The Balance Sheet for this condition would be as follows:

Balance Sheet
Brown & Jones

Sundry Assets......	\$38,000.00	Brown, Capital	\$45,333.33
Cash	30,000.00	Jones, Capital......	22,666.67
	\$68,000.00		\$68,000.00

§ 195. Purchasing an Interest in the Profits of a Business

Problem. Suppose, again, the agreement stated that the investment of \$30,000 by Jones entitled him to one third of the profits of the business. How would the Capital accounts stand?

Solution. The only entry necessary in this case is to take up the cash contributed by Jones and give him credit for such contribution. The opening Balance Sheet of the firm would be:

Balance Sheet
Brown & Jones

Sundry Assets	\$ 38,000	Brown, Capital.......	\$ 38,000
Cash	30,000	Jones, Capital........	30,000
	\$ 68,000		\$ 68,000

Notice that the Capital accounts are not in the same ratio to each other as the ratio in which the partners share profits and losses. The Capital accounts show the contributions of each partner, and their present interests in the firm assets. This interest has no relation whatsoever to the profit sharing ratio; such condition is common.

§ 196. Further Illustrations Concerning the Admission of a Partner

To illustrate further the basic principles underlying the admission of a partner, let us consider two or three problems separate in themselves and determine their solution. Bear in mind in all cases that it is necessary to determine:

1. The exact nature of the agreement in existence between the persons
2. The division of interest between the parties
3. What each party actually contributes to the new firm

Sometimes this determination is almost impossible, either because all the necessary facts relative thereto have been omitted intentionally from the problem in question, or because such necessary facts have been poorly expressed. To this end, one well known accountant states about as follows:

> "Possibly from the requirement as to the balance sheet, the new partners are to contribute new capital; not buy a share of the old business. The manner of making the entries depends upon whether the new partners contributed new capital or bought a share of ....'s interest."

In the latter case, the transaction is a personal one and would not enter into the business.

Problem 1. A, B and C formed a partnership, investing A, $10,000; B, $8,000, and C, $6,000. Profits and losses are shared equally. D was admitted to the firm at a later date on the basis of buying a one-fourth interest in the goodwill of the concern for $4,000. How would the $4,000 invested by D be handled upon the firm's books, and how would the Capital accounts of the partners stand after his entry into the firm?

Solution. The following Journal entries indicate the handling of the $4,000 upon the books of the firm:

1. Cash	$ 4,000	
To—D, Capital		$ 4,000
To record the amount paid in by D for his interest in this firm as per agreement of..............		
2. D, Capital	$ 4,000	
To—A, Capital		$ 1,333.34
B, Capital		1,333.33
C, Capital		1,333.33
To record distribution to A, B and C equally, of the profit secured from the sale of a one-fourth interest to D		

The Capital accounts of the partners, after the above entries have been posted, will appear as follows:

	A	*B*	*C*	*D*
Investment ....Cr.	$10,000.00	$8,000.00	$6,000.00	$4,000.00
Capital profit, goodwill sale...Cr.	1,333.34	1,333.33	1,333.33	....
	$11,333.34	$9,333.33	$7,333.33	$4,000.00
Distribution of investment....Dr.	....	....	....	4,000.00
Balance, after entries posted..Cr.	$11,333.34	$9,333.33	$7,333.33	....

The Capital account balances are seen to be unequal, yet profits and losses are shared equally.

Problem 2. A and B are partners, sharing profits and losses equally. A Balance Sheet prepared from their books as of December 31, 1919, was as follows:

Balance Sheet
A & B
December 31, 1919

Assets	
Cash	$ 500.00
Accounts Receivable	61,000.00
Merchandise Inventory	35,000.00
Investments	3,000.00
Furniture and Fixtures	2,500.00
Total Assets	$102,000.00
Liabilities and Capital	
Accounts Payable	$ 50,000.00
Bank Overdraft	15,000.00
Total Liabilities	$ 65,000.00

A, Capital	21,000.00
B, Capital	16,000.00
Total Liabilities and Capital	$102,000.00

C agrees to buy a one-third interest in this firm for $5,000, making an investment in the firm of that amount provided the above Balance Sheet is adjusted as concerns the following: $15,000 is to be written off for bad debts; $500 from furniture and fixtures; 15% from inventory; 25% on investments. A and B agree to this, provided C agrees to the establishment of a Goodwill account in the amount of $5,000. C agrees to this provision. Present the opening Balance Sheet of the new firm.

Solution. The Balance Sheet of the new firm of A, B and C is as follows:

Balance Sheet
A, B & C
(Date)

Assets

Cash		$ 5,500.00
Accounts Receivable	$61,000.00	
Less—Reserve for Bad Debts	15,000.00	46,000.00
Merchandise Inventory	$35,000.00	
Less—Reserve for Shrinkage	5,250.00	29,750.00
Investments	$ 3,000.00	
Less—Reserve for Loss	750.00	2,250.00
Total Current Assets		$83,500.00
Furniture and Fixtures	$ 2,500.00	
Less—Reserve for Depreciation	500.00	2,000.00
Goodwill		5,000.00
Total Assets		$90,500.00

Liabilities and Capital

Accounts Payable	$50,000.00
Bank Overdraft	15,000.00
A, Personal	7,750.00
B, Personal	2,750.00
Total Current Liabilities	$75,500.00

A, Capital	5,000.00
B, Capital	5,000.00
C, Capital	5,000.00
Total Liabilities and Capital....	$90,500.00

Problem 3. Y and Z are partners, drawing equal amounts for services and sharing profits in accordance with capital investment, after allowing 5% on capital. In order to acquire additional capital they agree to admit X to the firm, who is to own a one-fourth interest in the business. According to the balance sheet, Y has $8,000, and Z $4,000, invested. Goodwill is valued at $4,000.

What sum must X contribute? How will the partners' accounts appear after payment into the firm of X's capital, and how will future profits be divided?
Show the accounts in skeleton form. (C.P.A.)

Solution. The Balance Sheet of Y and Z prior to the incoming of X is as follows:

Balance Sheet
Y & Z
(Date)

Sundry Assets......	$12,000.00	Y, Capital..........	$ 8,000.00
		Z, Capital	4,000.00
	$12,000.00		$12,000.00

The item of goodwill does not yet appear to be on the books. Therefore, the following entry will be made relative thereto, dividing the item in proportion to capital invested:

Goodwill	$ 4,000.00	
To—Y, Capital....................		$ 2,666.67
Z, Capital		1,333.33

The Balance Sheet will now stand as follows:

Balance Sheet
Y & Z
(Date)

Sundry Assets	$12,000.00	Y, Capital..........	$10,666.67
Goodwill	4,000.00	Z, Capital..........	5,333.33
	$16,000.00		$16,000.00

It is upon the basis of this Balance Sheet that X makes his investment.

X is to invest an amount which will give him a one-fourth interest in the firm. Therefore, at the present moment, the total assets of $16,000 represent three-fourths of the amount the new firm is to have, or $21,333.33. To this end, the contribution of X must amount to $5,333.33, in order to produce the new capital. After this amount is contributed, the opening Balance Sheet of the new firm will be:

Balance Sheet
Y, Z & X
(Date)

Sundry Assets	$12,000.00	Y, Capital	$10,666.67
Goodwill	4,000.00	Z, Capital	5,333.33
Cash	5,333.33	X, Capital	5,333.33
	$21,333.33		$21,333.33

The status of the partners' Capital accounts is shown by the following:

	Y	*Z*	*X*	*Total*
Original Contributions	$ 8,000.00	$4,000.00	....	$12,000.00
Goodwill	2,666.67	1,333.33	....	4,000.00
Total	$10,666.67	$5,333.33	....	$16,000.00
Contribution by X	....	....	5,333.33	5,333.33
Total	$10,666.67	$5,333.33	$5,333.33	$21,333.33

Future profits, based upon the above, will be divided:

Y—½
Z—¼
X—¼

§ 197. Partnership Consolidation

Some of the reasons for the consolidation of partnerships may be set out about as follows:

1. Elimination of competition
2. Securement of coöperation

3. Coördination of operations
4. Saving in labor costs
5. Etc.

The accounting problem here involved is that of the admission of a new partner, since the underlying principles are similar, so far as the type of problem is concerned.

Some of the new principles incident to partnership consolidation may be stated briefly as follows:

1. Assets must be revalued, in which revaluation all concerned must agree
2. The valuation of goodwill
3. Determination of earning capacity of each firm
    a) This has a distinct bearing upon the valuation of goodwill
    b) Earning capacity of each firm must be equalized with that of each other firm. Only in this way can earning capacity be compared equitably. The points for specific consideration here are:
        1. Partners' salaries
        2. Partners' withdrawals
        3. Interest on capital
        4. Loans
        5. Non-operating profits

CHAPTER X

PARTNERSHIP ACCOUNTING (Continued)

§ 198. Partnership Profits

In a partnership, as in a single proprietorship, the owner or owners invest not only capital but their time and effort; on the other hand, in a corporation, the investment is one of capital only.

In a partnership, ordinarily, the members are presumed to be active and in direct management of the business. When one partner is not so engaged, his share of the profits is reduced proportionately; or at least it should be. This reduction takes the form of an allowance to the others of salaries before any distribution of profits in the agreed ratio is made. Partnership profits, therefore, may contain the element of salary. One who invests both capital and effort expects as profit therefor an amount which will give him a fair return on the capital investment and also compensation for the services rendered the enterprise. His return on the capital invested is expected, usually, to be a higher rate than that returned upon an investment in sound securities. This is due to the element of risk incident to carrying on a partnership enterprise as compared to investing money in sound securities. Partnership profits, therefore, contain two elements:

1. Interest upon investment
2. Compensation for services rendered

In view of the above discussion, a definition of partnership profits may be attempted. The net profit of a part-

nership is the profit determined before interest upon investment and compensation for services rendered are considered. Interest on capital and partners' salaries, therefore, should be considered as deductions from surplus net profit before any distribution is made in accordance with the partnership agreement.

§ 199. Division of Profits

Basically, the distribution of net profits, at the time of closing the books, may be set out as follows:

1. When no agreement exists as to how they should be shared
   - a) The law gives each partner an equal share in the profits and assumes the losses are to be borne equally

2. When an agreement exists as to how they shall be shared
   - a) In proportion to the amounts of capital originally contributed
   - b) In proportion to the amounts of capital existing as at the time of dividing profits
   - c) In proportion to the capital invested and the time employed
   - d) In any proportion agreed upon, regardless of original investment or of whether a certain partner has made any investment

Losses are borne always in the same proportion as profits are shared, unless the agreement states to the contrary. To secure a distribution of profits, a closing entry is made in one of two ways, as follows.

1. (a) Profit and Loss Account............$¢
        To—A, Drawing Account ....$¢
             B, Drawing Account ....$¢
             C, Drawing Account ....$¢

(b) A, Drawing Account..............$¢
B, Drawing Account..............$¢
C, Drawing Account..............$¢
To—A, Capital Account............$¢
B, Capital Account............$¢
C, Capital Account............$¢

2. Profit and Loss Account.........$¢
To—A, Capital Account............$¢
B, Capital Account............$¢
C, Capital Account............$¢

The Drawing accounts under method No. 2 are closed into the Capital accounts separately

Usually, it is advisable to follow the second method because, by so doing, a glance at the Capital accounts will show the profits or losses separately from the drawings; whereas, under the first method, to determine these two facts, one must look in two places instead of in one,—both at the Drawing accounts and at the Capital accounts.

At times, before the partners' share in the profits is determined, some part of the profit amount is reserved for a specific purpose. In such case, the Profit and Loss account will be charged and the requisite Reserve account credited. These reserves are not of the same character as valuation reserves (like Reserve for Depreciation of Machinery). The setting aside of a profit reserve is unusual in partnership accounting, being more of a corporate expedient than that of a partnership.

§ 200. Partnership Balance Sheet and Statement of Profits and Income

To illustrate the method of closing a set of partnership books and preparing the requisite statements therefrom, the following problem and its solution are given.

Problem. The following Trial Balance was drawn

from the books of Bennett, Roe and Coe at December 31, 1919.

Bennett, Capital		$ 50,000.00
Roe, Capital		50,000.00
Coe, Capital		25,000.00
Bennett, Drawings	$ 4,000.00	
Roe, Drawings	3,000.00	
Coe, Drawings	5,000.00	
Land	45,000 00	
Plant, Machinery & Tools	70,000.00	
Inventory at January 1, 1918	30,815.00	
Accounts Receivable	20,250.00	
Notes Receivable	5,000.00	
Cash	1,785 00	
Insurance	115.00	
Notes Payable		35,000.00
Accounts Payable		43,725.00
Purchases	28,254.00	
Wages	131,171.00	
General Factory Expense	10,085.00	
Rent of Sales Office	1,000.00	
Office Salaries and Expense	62,850.00	
Sales		215,950.00
Interest (net)	1,350.00	
	$419,675.00	$419,675.00

The inventory at December 31, 1919, is valued at $25,022.00, insurance unexpired amounts to $28.00. The partnership agreement provides:

(1) That interest shall be credited at 6% per annum on capital invested.

(2) That the net profit or loss after making the above interest provisions shall be divided in the following ratios:

Bennett	1/2
Roe	1/4
Coe	1/4

Prepare Closing entries, Balance Sheet, and Statement of Profits and Income.

Solution. The solution of the above problem is set out as follows:

Bennett, Roe & Coe
Balance Sheet
December 31, 1919 — Exhibit "A"

Assets

Current Assets:		
Cash	$ 1,785.00	
Accounts Receivable	20,250.00	
Notes Receivable	5,000.00	
Inventory	25,022.00	
Unexpired Insurance	28.00	
Total Current Assets		$ 52,085.00
Capital Assets:		
Plant, Machinery and Tools	$ 70,000.00	
Land	45,000.00	
Total Capital Assets		$115,000.00
Total Assets		$167,085.00

Liabilities and Capital

Current Liabilities:		
Accounts Payable	$ 43,725.00	
Notes Payable	35,000.00	
Total Current Liabilities		$ 78,725.00
Capital:		
Bennett	$ 32,930.00	
Roe	41,965.00	
Coe	13,465.00	
Total Capital		$ 88,360.00
Total Liabilities and Capital		$167,085.00

Bennett, Roe & Coe
Statement of Profits & Income
for year ended Dec. 31, 1919 — Exhibit "B"

Inventory at Jan. 1, 1919	$ 30,815.00	Sales		$215,950.00
Purchases	28,254.00	Inventory at December 31, 1919		25,022.00
Wages	131,171.00	Net Loss from Operation		24,640.00
Insurance	87.00			
General Factory Expenses	10,085.00			
Rent of Sales Office	1,000.00			
Office Salaries and Expenses	62,850.00			
Interest	1,350.00			
	$265,612.00			$265,612.00
Net Loss from Operation	$ 24,640.00	Net Loss		$ 32,140.00
6% interest on Partner's Capital	7,500.00	Distributed as follows:		
		Bennett	$16,070.00	
		Roe	8,035.00	
		Coe	8,035.00	
			$32,140.00	
	$32,140.00			$32,140.00

CLOSING ENTRIES

(1)

Unexpired Insurance	28.00	
To Insurance		28.00
To take up amount of insurance unexpired at Dec. 31, 1919.		

(2)

Interest on Partners' Capital	7,500.00	
To Roe Drawings		3,000.00
Bennett Drawings		3,000.00
Coe Drawings		1,500.00
To credit Partners with 6% interest on capital invested January 1, 1919, as per partnership agreement.		

(3)

Inventory	25,022.00	
To Purchases		25,022.00
To set up value of inventory on hand Dec. 31, 1919.		

(4)

Profit and Loss	248,090.00	
To Inventory, January 1, 1919		30,815.00
Purchases		3,232.00
Wages		131,171.00
Insurance		87.00
General Factory Expenses		10,085.00
Rent of Sales Office		1,000.00
Office Salaries and Expenses		62,850.00
Interest (net)		1,350.00
Interest on Partners' Capital		7,500.00
To close.		

(5)

Sales	215,950.00	
To Profit and Loss		215,950.00
To close.		

(6)

Bennett, Capital	16,070.00	
Roe, Capital	8,035.00	
Coe, Capital	8,035.00	
To Profit and Loss		32,140.00
To record distribution of loss for year as per agreement.		

(7)

Bennett, Capital	1,000.00	
Coe, Capital	3,500.00	
To Bennett, Drawings		1,000.00
Coe, Drawings		3,500.00
To close.		

Schedule of Drawing Accounts

	Bennett	*Roe*	*Coe*	*Total*
Drawings ....Dr.	$ 4,000.00	$ 3,000.00	$ 5,000.00	$12,000.00
Interest on Capital.....Cr.	3,000.00	3,000.00	1,500.00	7,500.00
Balance to Capital.....Dr.	$ 1,000.00	....	$ 3,500.00	$ 4,500.00

Schedule of Capital Accounts

	Bennett	*Roe*	*Coe*	*Total*
Balance, January 1/19	$50,000.00	$50,000.00	$25,000.00	$125,000.00
Losses	16,070.00	8,035.00	8,035.00	32,140.00
	$33,930.00	$41,965.00	$16,965.00	$92,860.00
Drawings	1,000.00	....	3,500.00	4,500.00
Balance, December 31	$32,930.00	$41,965.00	$13,465.00	$88,360.00

§ 201. Division of Profits Based on Capital Originally Contributed

When the partnership agreement provides that profits shall be divided in proportion to the capital originally contributed by the partners, no difficulty is encountered. Due care must be observed, however, to determine what the original contributions were.

If A contributed $500, B $1,000, and C $2,500, the total original contribution amounts to $4,000. If the total profits amount to $1,600, A will receive $200, B $400, and C $1,000; A receives ⅛, B ¼, and C ⅝.

§ 202. Division of Profits Based on Capital Originally Contributed and Accumulated

Under this method of dividing profits, due consideration must be given to the capital existing at the time profits are divided. Suppose in the above illustration that the profits as divided were left in the business. A's capital then would be $700, B's $1,400, and C's $3,500. Suppose that during the second year, each partner had drawn out $100, and that the profits for the year were $10,600. The capital accumulations at the end of the second year would be: A $600, B $1,300, and C $3,400. A's share of the profits would be 6/53 or $1,200, B's 13/53 or $2,600, and C's 34/53 or $6,800.

The capital ratio and the profit sharing ratio here are the same,—6, 13, 34, whereas in the last section it was seen to be 1, 2, 5, or 6, 12, 30.

§ 203. Division of Profits Based on Capital Contributed and Time Employed

A third basis of profit distribution may be employed, that of dividing profits in proportion to the capital invested and the time such capital remains in the business. The discussion of this method is based upon the following problem.

Problem. McDonald and Smith form a partnership January 1, 1918, each investing $7,500. March 1, Smith makes an additional investment of $3,400, and McDonald withdraws $1,200. July 1, McDonald invests $2,500 and Smith withdraws $2,500. The profits for the year are $4,800. Show each partner's average investment and share of profits, the profits being divided in the proportion of the capital invested and the time it is employed.

Solution. To solve this problem, the average investment of each partner must be ascertained before it is possible to determine what shall be the division of the profits. The average investment of a partnership is that fund which, if placed at interest for a given time, will earn the same amount of interest as the various amounts invested by the partners for varying periods of time.

In this problem, the investments and withdrawals were all made on the first day of the month; therefore, the month may be used as the unit of time in determining the average investment of each partner. If the investments and withdrawals were not made on the first day of the month, the unit of time necessarily, would have to be the day.

McDonald invested on January 1, the sum of $7,500. This sum was invested for a period of two months, because on March 1, he withdrew $1,200; his investment, therefore, changed on March 1. When he withdrew the $1,200, his investment amounted to $6,300, and this latter

amount remained unchanged until July 1. On July 1, an additional investment of $2,500 was made, bringing up his total investment to $8,800. This $8,800 remained unchanged until the end of the year 1919, a period of eight months.

With the above data, the average investment of McDonald may be calculated. To determine the average investment of Smith, it would be necessary to proceed in a similar manner.

The solution is continued as follows:

McDonald

1918			1918		
Mar. 1		$ 1,200.00	Jan. 1		$ 7,500.00
Dec. 31	Balance	11,009.94	July 1		2,500.00
			Dec. 31	Profit	2,209.94
		$12,209.94			$12,209.94
			1919		
			Jan. 1.	Balance	$11,009.94

Smith

1918			1918		
July 1		2,500.00	Jan. 1		7,500.00
Dec. 31	Balance	10,990.06	Mar. 1		3,400.00
			Dec. 31	Profit	2,590.06
		13,490.06			13,490.06
			1919		
			Jan. 1	Balance	10,990.06

McDonald:

$7,500 for 2 months is $15,000 for 1 month
$6,300 for 4 months is $25,200 for 1 month
$8,800 for 6 months is $52,800 for 1 month

$93,000 for 1 month

Smith:

$ 7,500 for 2 months is $ 15,000 for 1 month
$10,900 for 4 months is $ 43,600 for 1 month
$ 8,400 for 6 months is $ 50,400 for 1 month

$109,000 for 1 month

$93,000 plus $109,000 is $202,000, Total Average Investment
$93,000 is $\frac{93}{202}$ of $202,000, Share of McDonald in profits
$109,000 is $\frac{109}{202}$ of $202,000, Share of Smith in profits
$\frac{93}{202}$ of $4,800 is $2,209.94, Share of McDonald in profits
$\frac{109}{202}$ of $4,800 is $2,590.06, Share of Smith in profits

§ 204. Division of Profits Based on Ratio Different from Capital Ratio

Partners may agree to share profits in any proportion regardless of the amounts of capital contributed to the business. Such procedure frequently is made use of to adjust inequalities between the partners. One partner may devote more time to the business than the others, and if he does not receive a salary larger in amount than the rest, the inequality may be adjusted when profits are shared by allowing him a larger share thereof than otherwise would be the case. This division of profits on a time basis is not at all uncommon.

Again, one partner may place his skill and ability against the larger property investment of the others. Skill and ability are valuable assets; they may be the most valuable assets a business possesses, and yet they cannot find expression in the Ledger accounts. To adjust this inequality, from the standpoint of the written records of the business, the partner with skill and but little cash investment, if any at all, may be given a greater share in the profits than the Capital accounts would suggest.

§ 205. Interest Allowed on Capital Contributions

Charging interest on partners' investments and drawings has a double purpose:

> 1. To determine the actual business profits after allowing for a normal return on the investment. A business enterprise is expected to show, first, a reasonable return on the capital invested. All profits realized beyond this interest return are regarded as the true business profits—profits from the economic point of view.
>
> 2. To secure an equitable adjustment of irregular investments and drawings.

When interest is not allowed on partners' capital, the following results:

1. If investments are equal and the profit sharing is in unequal portions, the partner who is entitled to the smaller ratio of the profits loses.
2. If profits are shared equally, but the investments are unequal, the partner with the larger investment loses.
3. If the investments are unequal, and the partners, also, share profits unequally, the result upon the partners depends upon the proportion in which the profits are shared and the respective investments of each partner.

* Therefore, the only condition under which neither partner would lose is where profits are shared in proportion to investments, and all partners draw equally and at the same time.

Other points to keep in mind concerning interest on investments and on drawings are as follows:

1. When interest is allowed on each partner's investment, an adjusting entry should be made charging Interest on Partners' Capital account and crediting the Capital account, or Drawing account, of each partner.
2. Interest should be calculated on the capitals as at the beginning of the period, additions to capital during the period being entitled to interest for the time employed.
3. Interest should be charged on each drawing from the date the withdrawal was made to the end of the period. An adjusting entry should be passed charging the partner's Capital, or Drawing, account, and crediting Interest on Partners' Capital account.
4. Five or six per cent. is the usual rate to use in calculating interest on capital and on drawings.
5. The same net result may be secured, so far as its effect on the partners' balances is concerned, by crediting or debiting interest on the excess or deficit

which each partner's contribution shows in relation to the average capital. For example: A, B and C, as partners, may have invested $100,000, $80,000, and $60,000, respectively,—a total investment of $240,000. The average capital is $80,000. A would be entitled to interest on the amount of his investment in excess of the average, or $20,000; C would be charged interest on a deficit of $20,000; and B, having the average amount invested, would be neither charged nor credited with interest.

Interest adjustments usually are handled through the Profit and Loss account, and the adjusting debit or credit balance resulting therefrom is then distributed to the partners in their profit sharing or loss sharing ratio. These adjustments, however, are not business expenses, and should be made just prior to the eventual distribution of the surplus net profit.

The following two problems with their solutions suggest how, in general, the item of interest on capital should be handled.

Problem 1. A, B and C formed a partnership on January 1, 19—, the investment being as follows: A, $35,000; B, $35,000; C, $30,000. The partnership contract provides that interest shall be credited to the respective partners' capital accounts at the beginning of each year at the rate of 6% per annum. The profits and losses are shared: A, 3/10; B, 3/10; C, 4/10. The profits for the first year of business, before considering the item of interest were $42,500. Prepare the capital accounts of the partners to conform to the above provisions.

Solution to Problem 1. The capital accounts are shown below:

	A	*B*	*C*	*Total*
Investment, Jan. 1, 19—...	$35,000.00	$35,000.00	$30,000.00	$100,000.00
6% Interest on Capital....	2,100.00	2,100.00	1,800.00	6,000.00
Net Profit for Year.......	10,950.00	10,950.00	14,600.00	36,500.00
Investment, Dec. 31, 19—..	$48,050.00	$48,050.00	$46,400.00	$142,500.00

Problem 2. Upon the understanding that profits and losses were to be shared equally, and that interest at the rate of 5% per annum was to be charged on partners' capital, A and B formed a partnership. A invested $25,000, and B invested $10,000. The loss incurred during the first year of business amounted to $1,200. Show the Profit and Loss account for the above condition.

Solution to Problem 2. Inasmuch as under the partnership agreement interest was to be allowed on the partners' capital, the first entry required, after the loss of $1,200 had been shown in the Profit and Loss account, would be to charge Profit and Loss, in a final section of the account, for the amount of interest to which the partners were entitled, a corresponding credit being made to the partners' accounts. The final balance in the Profit and Loss account would then be transferred to the partners' accounts, the amount being divided equally in accordance with the agreement. The final section of the Profit and Loss account would stand as follows:

19—		19—	
Balance, Net Loss	1,200.00	A, Personal Account	1,475.00
A, Personal (5% int.)	1,250.00	B, Personal Account	1,475.00
B, Personal (5% int.)	500.00	(to close)	
	2,950.00		2,950.00

§ 206. First Method of Adjusting Interest on Capital Contributions

Three methods are available for adjusting interest on capital contributions. They are shown in connection with the solution of the following problem. In this problem, two of the partners have not contributed their agreed-upon share of investment, whereas, the third partner has done so. Those who have not done so,—have not contributed the amounts agreed upon, should be charged with interest upon their deficiencies; this method seems to be a most equitable one.

Problem. A, B and C agree to start in business with a capital of \$400,000, of which A is to furnish \$200,000, B \$100,000, and C \$100,000. A is to have ½ interest in the business, and B and C each ¼ interest, and interest at the rate of 5 per cent. per annum is to be paid on excess capital, if any. A contributes \$200,000, B \$90,000, and C \$80,000. How would the capital accounts stand on the books after adjusting the interest account at the end of the year? (C.P.A.)

Solution. This solution is based upon considering the respective excesses or deficits on capital contributions. A invested \$200,000; he was to furnish \$200,000. Therefore, he furnished no excess. B invested \$90,000; he was to furnish \$100,000. Therefore, he had a deficiency of \$10,000, the interest on which for the year is \$500. C invested \$80,000; he was to furnish \$100,000. Therefore, he had a deficiency of \$20,000, the interest on which for the year is \$1,000.

The following Journal entry brings these interest items upon the books:

B, Capital	500.00	
C, Capital	1,000.00	
To—Profit and Loss..................		1,500.00

The Profit and Loss account then shows a credit balance of \$1,500, which is distributed as follows, per agreement:

Profit and Loss........................	1,500.00	
To—A, Capital (½).................		750.00
B, Capital (¼).................		375.00
C, Capital (¼).................		375.00

The Capital accounts now stand:

A—Capital Account

19—		19—	
Balance	200,750.00	Investment	200,000.00
		Profit and Loss	750.00
	200,750.00		200,750.00
		19—	
		Balance	200,750.00

B—Capital Account

19—		19—	
Profit and Loss	500.00	Investment	90,000.00
Balance	89,875.00	Profit and Loss	375.00
	90,375.00		90,375.00
		19—	
		Balance	89,875.00

C—Capital Account

19—		19—	
Profit and Loss	1,000.00	Investment	80,000.00
Balance	79,375.00	Profit and Loss	375.00
	80,375.00		80,375.00
		19—	
		Balance	79,375.00

§ 207. Second Method of Adjusting Interest on Capital Contributions

Problem. Same as in last section above.

Solution. In this solution the interest is calculated on the whole capital contributed by each partner. The following Journal entry will bring the interest upon the books:

Profit and Loss	18,500.00	
To—A, Capital....................		10,000.00
B, Capital....................		4,500.00
C, Capital....................		4,000.00

The debit amount in the Profit and Loss account is then distributed as follows:

A, Capital (½).....................	9,250.00	
B, Capital (¼).....................	4,625.00	
C, Capital (¼).....................	4,625.00	
To—Profit and Loss..............		18,500.00

The Capital accounts now stand:

A—Capital Account

19—		19—	
Profit and Loss	9,250.00	Investment	200,000.00
Balance	200,750.00	Profit and Loss	10,000.00
	210,000.00		210,000.00
		19—	
		Balance	200,750.00

B—Capital Account

19—		19—	
Profit and Loss	4,625.00	Investment	90,000.00
Balance	89,875.00	Profit and Loss	4,500.00
	94,500.00		94,500.00
		19—	
		Balance	89,875.00

C—Capital Account

19—		19—	
Profit and Loss	4,625.00	Investment	80,000.00
Balance	79,375.00	Profit and Loss	4,000.00
	84,000.00		84,000.00
		19—	
		Balance	79,375.00

§ 208. Third Method of Adjusting Interest on Capital Contributions

Problem. Same as before.

Solution. The total capital contributed is $370,000. A's actual investment is $30,000 in excess of that of B and C combined. Yet to preserve the same ratio of interest, A must keep intact one-half the actual capital contributed. Since the total actual capital is $370,000, and the share thereof that A must keep intact is ½ or $185,000, and since he has actually invested $200,000, he can lend only (in theory) $15,000 to B and C together. It is on this amount, $15,000, that A is entitled to interest at 5%,—on $2,500 from B and $12,500 from C.

Name	Agreed Investment	Actual Investment	Intact Amount	Excess	Deficit	Interest
A	$200,000	$200,000	$185,000	$15,000	......	½
B	100,000	90,000	92,500	......	$ 2,500	¼
C	100,000	80,000	92,500	......	12,500	¼
		$370,000	$37,0000	$15,000	$15,000	

The Journal entry does not, in this case, make the adjustment through the Profit and Loss account as in the

solution shown in each of the last two sections. The interest item is adjusted between the partners, as follows:

B, Capital Account........................	125.00	
C, Capital Account........................	625.00	
To—A, Capital Account................		750.00

The Capital accounts now stand:

A—Capital Account

19—		19—	
Balance	200,750.00	Investment	200,000.00
		B, Capital	125.00
		C, Capital	625.00
	200,750.00		200,750.00
		19—	
		Balance	200,750.00

B—Capital Account

19—		19—	
A, Capital	125.00	Investment	90,000.00
Balance	89,875.00		
	90,000.00		90,000.00
		19—	
		Balance	89,875.00

C—Capital Account

19—		19—	
A, Capital	625.00	Investment	80,000.00
Balance	79,375.00		
	80,000.00		80,000.00
		19—	
		Balance	79,375.00

These three solutions to the same problem lead to the same results. However, it should be noticed that in the problem presented the agreed upon investments were to be in the same ratio as the sharing of profits and losses; only when the profit and loss sharing ratio is the same as the ratio between the agreed-upon investments will each of the three results be similar one with the others.

§ 209. Interest on Partners' Loans

Interest on partners' loans should be distinguished from interest on partners' investments. The cost of an outside loan is an expense of doing business to be taken up on the books before net profits are determined. The same principle holds true in regard to partners' loans. Their cost (interest) is a legitimate charge to the Interest Lost account, the credit entry being made to either the Drawing account of the lending partner or to the Cash account.

§ 210. Insurance on Partner's Life

It is a common practice for a partnership to take out insurance to protect the firm against loss due to the death of a partner. In some instances, the life of a valuable employee may be insured.

The question then presents itself, How much of the policy premium is chargeable against profits? May the entire premium be capitalized, or may the premium be apportioned and partly capitalized? Under no condition should the whole premium be capitalized. As to whether or not a part of the premium may be capitalized depends upon the kind of insurance in force; most insurance policies issued against partners' lives are either straight life or term policies. In term insurance, the whole premium should be charged against profits, because in such policies there is lacking what is known as "cash surrender value." Only when a policy has a cash surrender value may part of the premium be charged against profits, the remainder being capitalized.

An insurance premium is made up of three parts:

1. The loading (overhead)
2. The death risk. The amount to cover the insurance for the year
3. The amount to cover future risk

The theory of the level premium is to pay a larger premium in the beginning so that the premium in later years, when a person's earning capacity may decline, will not be too high to be met. Therefore, an examination of the above three points shows that actually a premium does not consist of "protection and investment." No part of the premium is an investment. Part No. 1, is an expense to cover the expenses of the insurance company; part No. 2, is to pay for the insurance for the year; and part No. 3, is to provide for future years' insurance. This latter part has to do with what is known as "surrender value," a value which the insurance company will return when the policy is surrendered. When a policy has been surrendered, the insurance company no longer needs to accumulate funds to provide for future risk.

A man's value to a firm is his earning power. Therefore, it is assumed that when he dies the profits of the enterprise will decline, at least for a certain length of time. The money received from an insurance policy carried on the life of the deceased person, during the first few years after his death, represents the replacing of the earning power lost on account of such death.

In any event, each case should be decided separately, and the most that should be capitalized is the cash surrender value of the policy, if the policy has a surrender value. No policy has a cash surrender value until after three full annual premiums are paid; i.e., not until the end of the second year.

As to the entries to be made, where the cash surrender value is to be taken up on the books, two different views or methods are followed by accountants, these methods referring to the booking of the first three annual premiums. Briefly, these views are as follows:

Method No. 1. Since there is no cash surrender value until after three full annual premiums have been

paid, some accountants hold that, in recording these three premium payments, nothing should be taken up on the books in the way of surrender value. The amounts paid as premiums during this period should be considered entirely as an operating expense.

Method No. 2. To other accountants, Method No. 1 appears objectionable in that there is a sudden change in the amount of the insurance expense after the third premium is paid, and that the Capital accounts are suddenly affected due to a condition that has been at work during the full three-payment period. These accountants hold, therefore, the better practice to be to capitalize during this period one-third of the cash surrender value as at the end of that time, charging only the remainder to an expense account. By so doing, the policy is placed on the books at once as an asset, and the insurance expense is equalized during the period the policy is in force.

As the years pass and the policy remains in force, the surrender value increases annually as the premiums are paid. During the subsequent periods following the payment of the third annual premium only the difference between the amount of the premiums and the increase in cash surrender value is considered as an operating expense. If the increase in surrender value is at any time greater than one year's premium, the difference is credited to Profit and Loss.

In case of the death of the insured partner, the amount received from the insurance company in payment of the death claim is credited to the asset account carried. The net proceeds then shown by this account is credited to Profit and Loss as a profit to be shared by the surviving partner, or partners, and by the estate of the deceased partner, as profits are shared.

Problem. The partnership "Black & White" has insured the lives of its partners for equal amounts. The

policies are payable to the firm. Premiums have been paid for five years. (a) Show the annual entries for each of the five years; (b) At the end of the fifth year White dies. What would be the proper entries to make upon receipt of the amount of the policy? (C.P.A.)

Solution. The solution to the above problem is shown according to each of the two possible methods indicated above. The author favors the first one. Since there is no cash surrender value until after three full annual premiums are paid, it would appear to be just as correct to show one third of the first cash surrender value as a capital charge at each of the first three premium payment dates as it would be to take up on a set of books as an asset, offset by an earning, dividends upon stock held before the board of directors of the company whose stock is held have declared a dividend; since dividends are not handled in this manner, it would seem that, so far as the first three annual insurance premiums are concerned, no part thereof should be capitalized until an actual cash surrender value has come into being.

METHOD No. 1	METHOD No. 2
First Year Payment a) Insurance Expense.......$ ¢ To—Cash .... $ ¢ To record policy premium.	Insurance Expense..........$ ¢ Cash Surrender Value (1/3 of first)............$ ¢ To—Cash .... $ ¢
Second Year Payment Insurance Expense.......$ ¢ To—Cash .... $ ¢ To record policy premium	Insurance Expense..........$ ¢ Cash Surrender Value (1/3 of first)............$ ¢ To—Cash .... $ ¢
Third Year Payment (1) Insurance Expense ..$ ¢ To—Cash .... $ ¢ To record policy premium (2) Upon first cash surrender date: Cash Surrender Value.$ ¢ To—Insurance Expense .... $ ¢	Insurance Expense..........$ ¢ Cash Surrender Value (1/3 of first)............$ ¢ To—Cash ....$ ¢

Fourth Year Payment (1) Insurance Expense...\$ ¢ To—Cash .... \$ ¢ To record policy premium (2) Upon second cash surrender date: Cash Surrender Value.\$ ¢ To—Insurance Expense .... \$ ¢	Do
Fifth Year Payment (1) Insurance Expense ..\$ ¢ To—Cash .... \$ ¢ To record policy premium (2) Upon third cash surrender date: Cash Surrender Value.\$ ¢ To—Insurance Expense ....\$ ¢	Do

b) Entries when amount of policy received after partner's death:

Cash ....\$ ¢
To—Cash Surrender Value \$ ¢
Profit and Loss..... \$ ¢

CHAPTER XI

PARTNERSHIP ACCOUNTING (Continued)

§ 211. Reasons for Dissolution

There is no need of going further into the details of partnership operation. These vary according to each line of business. The duration of a partnership, due to its essential character, is limited. Sooner or later, for one reason or other, the partnership business must be wound up. In this process of winding up, the accounts require considerable adjustment. Therefore, this phase of the subject demands consideration, before the discussion of partnership accounts is concluded.

A partnership may be dissolved for one of many reasons, the dissolution being either voluntary, by agreement of all the partners, or involuntary, against or without the consent of one or more of them.

> 1. Expiration of the term of the partnership agreement. If the agreement prescribes a definite period during which the partnership is to run, the termination of this period marks the termination of the partnership. Dissolution, in this event, will be in any particular manner set out in the partnership agreement; if such agreement is silent, the principles of the common law govern. The business may be continued; yet, a new partnership will be formed, actually in fact or impliedly in law. If the partnership is a special one, the completion of the act for which it was created dissolves the firm automatically.
>
> 2. Subsequent mutual agreement of the partners, making of no effect the original contract. Partners, at any time, regardless of agreement, may consent and agree to dissolution. If any of the partners wish

to continue the business, they may buy the interests of those who wish to retire. Mutual agreement usually is made use of when the business proves unprofitable, and when the partners seriously disagree among themselves.

3. Object of the partnership becomes illegal or impossible. When the object for which a partnership is formed becomes illegal, the partnership is dissolved automatically.

4. Sale and assignment of a partner's interest. The partnership relation is a personal one. Only those who entered into that relation can continue therein. When a partner's interest is sold, legally, the old partnership passes out of existence and a new one replaces it.

5. Admission of a partner. Same reasons as for No. 4.

6. Sale or transfer of a firm to another. This point is really one of dissolution by mutual agreement. A firm may change its form of organization to that of a corporation,—an excellent method of dissolving a partnership business which is worth keeping and continuing.

7. Bankruptcy of the firm. Creditors' claims must be satisfied out of the proceeds secured from the sale of the partnership assets. Insolvency is not bankruptcy; a firm may be insolvent for a long time and the partnership relation still exist. But if an assignment is made for the benefit of creditors, bankruptcy may be forced upon it. Likewise, a firm may be adjudicated a bankrupt. And when bankruptcy appears dissolution must take place.

8. Withdrawal of a partner. This point is partially covered in No. 2, above. A partner may become dissatisfied, or just desire to withdraw. The contract of partnership may not have been concluded. No one can stop this partner from withdrawing; usually, at all times he has the power to do so, even though perhaps not a right to do so. Infrequently, a Court may refuse a partner permission to withdraw. A withdrawn partner is liable for debts in-

curred while a member, and he may be liable after he has withdrawn if he has not given personal notice of his withdrawal to all creditor concerns with which the partnership has been doing business. Again, he may be guilty of committing a tort by withdrawing at an inopportune time, for which damages may be collected.

9. Death of any one of the partners.

10. Insanity or bankruptcy of any one of the partners. Ipso facto, a partnership is not dissolved under such circumstances; the others may dissolve if they so desire. Temporary insanity is not sufficient grounds for dissolution.

It is seen from the above that dissolution may either be agreed upon or enforced, and that a firm may be solvent or insolvent at dissolution. If the business is to be actually wound up, it should be agreed that some one, as trustee, take charge of the matters of settlement on behalf of the partners, as a director thereof. Legal dissolution should be avoided on account of its slowness and cost.

§ 212. Asset Application Upon Dissolution

In the dissolution of a partnership, the accounts of the enterprise must be adjusted in relation thereto. The assets must be reduced to cash, or at least partially so, in order that creditors may be paid. Losses must be made good, first, out of firm profits, then out of firm capital, and, lastly, by the partners individually making good the deficit in proportion to their respective shares. Upon dissolution, under the law partnership assets are applied in the following manner:

1. Firm debts to outside creditors
2. Advances on loans made by partners to the firm
3. Return of capital
4. Return of residue, if any, among the partners as profits, shared in the profit and loss sharing ratio.

Upon dissolution, an accounting may be demanded as

a right based upon the right to profits. An accounting will be necessary unless a settlement has been agreed to which will work as an estoppel of using such right. The usual procedure in an accounting is to appoint a referee, who may be a Master in Chancery, to examine and report upon the partnership in reference to terms, accounts kept, capital invested and drawn out, profits and losses, assets and liabilities, and in what proportion the sharing shall be made. Upon his report, the Court executes an order, and the person in charge of the winding up begins his duties carrying out the directions of this order.

If the partnership is insolvent, three accounting statements may be made use of:

1. Statement of affairs
2. Deficiency account. This statement supports the statement of affairs
3. Statement of realization and liquidation

These statements will not be discussed in the consideration of partnership accounts, being reserved for a later time, in the course of the second year.

§ 213. Winding Up the Business

When a partner is bought out, the partnership business as a going concern passes to the remaining partners. If bankruptcy or equity proceedings dissolve a partnership, a trustee or receiver takes control of affairs, and the partners turn over the assets to him. After they do this, they have nothing more to do with the business except to act in an advisory capacity toward the trustee or receiver. When a partnership is incorporated, the corporation, as a rule, will take over the assets, goodwill, name and firm location. In this way the business will be continued as a going concern with but little or no disturbance.

The partners acting together, or the liquidating part-

ner or partners, or the survivor, may wind up affairs when a partnership is terminated by agreement, by limitation, by insolvency, by insanity, or by death. The liquidating or surviving partner or partners should notify all persons dealing with the firm that the partnership is being dissolved and that he or they are winding up the affairs of it.

Existing contracts must be fulfilled; partnership property must be disposed of as advantageously as possible; debts and obligations must be discharged; and the remaining surplus must be distributed in accordance with the plan set out in the preceding section. The surviving or liquidating partners have no power to make new contracts which will bind the firm, or to engage in new business, unless these things are necessary to liquidation. As a rule, they are entitled to no compensation for their services for winding up the affairs. A liquidator may be paid either a commission on the amounts realized, or a salary. Such expenses may be adjusted between the partners privately, but they should be charged as part of the liquidation expenses.

§ 214. Sharing Losses

The expenses and losses incident to liquidation must be borne by all partners in the profit and loss sharing ratio, not in accord with the capital ratios. These losses are chargeable against their capital accounts. If the capital of any partner is not sufficient to satisfy the amount of his loss share, his capital account will show a debit balance, an amount which he must contribute to the partnership in order that all claims may be satisfied.

Prior to dissolution, the partnership books should be closed, and the division of losses or profits made in accord with the agreement of copartnership. After all liabilities are discharged, the remaining assets should exactly

equal in amount the total capital shown in the partners' Capital accounts as adjusted. The sharing of the remaining assets will then be determined by the Capital accounts balances. Any shrinkage in the assets in liquidation is a further loss to be divided according to prior agreement. A settlement with a withdrawn partner or with the estate of a deceased partner is based upon the condition of his Capital account, but need not be attended by the discharge of all debts or the conversion of the assets into cash, unless money for such settlement cannot be secured in any other way.

If a partner's Capital account contains a debit balance upon dissolution, that partner is indebted to the others. It may be that this indebtedness can never be collected even by legal process. If such is the case, the loss must be written off in the same manner as any other loss. And in this connection a difficulty arises.

Ordinary losses must be shared equally unless the agreement specifies otherwise. But in this case, the loss must be shared in a manner different from those already mentioned, because the partner whose account is uncollectible cannot be considered in the sharing of it. The following problem illustrates the point.

Problem. Brown, Jones and Smith are partners sharing profits, Brown 1/4, Jones 1/4, and Smith 1/2. Brown has been overpaid for some reason or other and as a result his Capital account shows a debit balance which proves to be uncollectible. The amount of this balance is $9,000. How should the loss be shared by Jones and Smith?

Solution. The loss cannot be divided Jones 1/4 and Smith 1/2, because by so doing 1/4 will be unaccounted for. As between Jones and Smith, their interests are in the proportion of 1/3 and 2/3, since their profit sharing ratios of 1/4 and 1/2 bear that relation to each other. Therefore,

the usual procedure of distributing the $9,000 loss is to charge ⅓ of it to Jones and ⅔ of it to Smith; in other words, Jones would be charged with $3,000 and Smith with $6,000.

§ 215. Bookkeeping Upon Dissolution: Realization of Assets Account

A going concern carries its assets at cost value, less an estimated amount for depreciation carried in Reserve accounts. When these assets are sold upon the dissolution of the firm, the realized price usually will be much less than the values thereof as displayed upon the concern's books.

The bookkeeping procedure for the ordinary realization of assets is best accomplished by opening a Realization of Assets account upon the Ledger. To this account will be charged all the assets at their book values; the account will be credited with all the balances held in the Depreciation Reserve accounts, since the latter are in the nature of suspended credits properly belonging to the asset accounts to which they apply. The amount of cash on hand need not be charged to this account since the cash already is in its final form as a realizable asset.

As the assets are sold and cash is collected therefrom, the Cash account is debited and the Realization of Assets account is credited. If assets are disposed of in kind to a partner, their book value should be debited to the Capital account of the partner receiving them, unless an agreement is made to take over these assets at a different value. When the last asset has been disposed of, the Realization of Assets account will indicate how near the realization came to producing the book values of the assets. A credit balance in the account indicates a profit, and a debit balance a loss. Such profits and losses are then distributed to the partners' Capital accounts in the

same way as other profits and losses. When this has been done, the Cash account balance should exactly offset the balances in the partners' Capital accounts. And lastly, the cash on hand as shown by the Cash account should be distributed in accordance with the balances in the Capital accounts.

§ 216. Disposal of the Business: Realization and Liquidation Account

A partnership business may be sold; sometimes it is sold to a corporation. Even if the same partners form a corporation, the process is practically the same since the new corporation is a different business organization. No matter to whom the business is sold, the entries therefor must be made upon the partnership books. These entries are simple in their nature. The principles underlying these entries were explained in connection with the sale of a sole proprietorship business to a partnership.

An account should be opened with the vendee. This account will record the amount for which the business is sold. Assume the two following possibilities:

1. The business is sold for an amount representing the partners' capital
2. The business is sold for an amount greater than the combined capitals

In the first case, the vendee should be debited with the assets turned over to him and be credited with the liabilities of the firm assumed by him. When the vendee is debited the asset accounts will be credited. When he is credited, the liability accounts will be debited. The net result here is that the balance of the vendee's account is offset by the balances in the various Capital accounts of the partners. When payment is made by the vendee, his account will be credited and the Capital accounts will

be debited. The cash received is distributed to the partners in accord with the amounts shown in their Capital accounts.

In the second case, the procedure is slightly different. A Realization and Liquidation account may be opened upon the books to which all the assets are debited and all the liabilities are credited. The debit balance in this account should then be equal exactly to the credit balances of the Capital accounts. An account with the vendee may then be opened and be debited with the sale price, the Realization and Liquidation account being credited. The credit balance in this account represents the amount of the goodwill of the partnership, at least what has been received for it. This goodwill item represents a profit to be distributed to the partners in the proportion in which they share profits and losses. At this point, the debit balance in the account of the vendee exactly offsets the total balances of the Capital accounts, as in case No. 1, above. When payment is made by the vendee, his account will be credited, the partners' Capital accounts will be debited, and the cash received will be distributed to the partners in accord with the amounts shown in their Capital accounts.

§ 217. Installment Distribution Upon Dissolution: Liquidating Dividends

The amounts paid a partner in settlement or in liquidation of his capital are called liquidating dividends. The dissolution of a firm may cover a considerable period of time; and the partners, as a rule, in such event, desire to have the money paid over to them as the cash becomes available for the purpose. This method is a proper one, because accumulating and retaining the cash fund until the last asset has been converted into cash is useless, if for no other reason than it deprives the partners

of the use of money to which they have a right and to which they are entitled.

But in this making of partial payments, from time to time, a danger exists. Until all the assets have been realized upon, there is no way of knowing exactly how much each partner eventually will receive. As a result, one may be paid more than the amount to which he is entitled; he thereby becomes indebted to the other partners who, in turn, might find it a difficult matter to secure reimbursement from the overpaid partner. Consequently, it is advisable at all times to take the steps necessary to avoid an overpayment.

Such overpayment may be avoided by making the first payments in such amounts as will reduce and adjust the partners' Capital accounts to the profit and loss sharing ratio. Losses on realization of assets are charged to the partners in the profit and loss sharing ratio. If the Capital account of one partner is so reduced that its size is not enough to meet his share of the unknown future realization losses, he will become indebted to the other partners. If, on the other hand, when liquidating dividends are being paid, the Capital accounts are adjusted so they are to each other in the profit and loss sharing ratio, future losses and future dividends may be divided in proportion to the capital ratio which now is the same as the profit and loss sharing ratio.

If a partner should object to receiving liquidating dividends in any other ratio than that of his Capital account, unless the ratio of his Capital account to the Capital accounts of the others is the same as his profit and loss sharing ratio, no dividends at all should be paid until a complete realization has taken place. Eventually, as a rule, this objecting partner will realize that such a method is very inconvenient, and he will

consent to the use of the installment method of distribution as described.

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§ 218. Dissolution Problems

To better bring out the idea of dissolution procedure, and to better illustrate the principles of partnership dissolution, the remaining portion of this chapter consists of a number of problems with their solutions. Most of the problems have been taken from various C.P.A. examinations. The grouping of these problems is more or less arbitrary, but is deemed sufficient for the purpose desired.

§ 219. Partners Agree to Dissolve

Problem 1. George and Allen are partners sharing profits and losses equally, George having invested $30,000, and Allen $20,000. The business has been unsuccessful and the partners agree to dissolve. The assets for distribution amount to $20,000. How should these assets be shared?

Solution to Problem 1. If the assets that eventually remain amount to only $20,000, there must have been a loss in the amount of $30,000. This is shown by the following simple Balance Sheet:

GEORGE & ALLEN
Balance Sheet

Assets	$20,000.00	George, Capital	$30,000.00
Net Loss	30,000.00	Allen, Capital	20,000.00
	$50,000.00		$50,000.00

The net loss of $30,000 is divided equally between George and Allen. When done, the Capital account of George shows a credit balance of $15,000, and the Capital account of Allen a credit balance of $5,000. Therefore, George would be entitled to $15,000 of the assets, and Allen to $5,000 of them.

Problem 2. A, B and C were partners carrying on business with a capital, December 31, 1900, of \$60,000, of which A's share was \$30,000, B's \$20,000, and C's \$10,000. Each partner was entitled to receive interest on his capital at the rate of 5% a year, and to share profits or losses in the following proportions: A seven-twelfths (7/12), B one-fourth (1/4), C one-sixth (1/6).

The partners agree July 1, 1901, to dissolve and wind up the business. All the partnership assets having been realized, and all liabilities and claims paid, excepting legal expenses amounting to \$500, there remained a balance of \$38,750 deposited in bank. The partners arranged for a final settlement to take place December 31, 1901. The cash in bank bears interest at 2½ from October 30, 1901. Adjust the partners' accounts and prepare a statement for settlement on the day specified. (C.P.A.)

Solution to Problem 2.

BALANCE SHEET

December 31, 1901

Cash		\$38,411.46	A, Capital, balance	\$30,000.00	
Net Loss		24,588.54	Interest at 5%	1,500.00	\$31,500.00
A (7/12)	\$14,343.32		B, Capital, balance	\$20,000.00	
B (1/4)	6,147.13		Interest at 5%	1,000.00	21,000.00
C (1/6)	4,098.09		C, Capital, balance	\$10,000.00	
	\$24,588.54		Interest at 5%	500.00	10,500.00
		\$63,000.00			\$63,000.00

CASH ACCOUNT

1901			1901		
July 1	Balance	38,750.00	Dec. 31	Legal Expenses	500.00
Dec. 31	Interest (2½% for 2 months)	161.46	31	A, Capital	17,156.68
			31	B, Capital	14,852.87
			31	C, Capital	6,401.91
		38,911.46			38,911.46

A, Capital Account

1901			1901		
Dec. 31	Net Loss	14,343.32	Jan. 1	Balance	30,000.00
31	Cash	17,156.68	Dec. 31	Interest	1,500.00
		31,500.00			31.500.00

B, Capital Account

1901			1901		
Dec. 31	Net Loss	6,147.13	Jan. 1	Balance	20,000.00
31	Cash	14,852.87	Dec. 31	Interest	1,000.00
		21,000.00			21,000.00

C, Capital Account

1901			1901		
Dec. 31	Net Loss	4,098.09	Jan. 1	Balance	10,000.00
31	Cash	6,401.91	Dec. 31	Interest	500.00
		10,500.00			10,500.00

Problem 3. A partnership on equal terms between A and B is dissolved July 1, 1897, the books on that date showing the following: A's capital paid in was $16,000, and his drawings were $3,500; B's capital paid in was $2,000, and his drawings were $1,500. Goods purchased were $50,000; sales $40,000; business expenses $1,800. A loss of $1,600 was made on a $5,000 consignment of goods to Liverpool. In the settlement A agrees to pay B an old debt of $3,500. Prepare requisite accounts, and show final balance payable by one partner to the other. (C.P.A.)

Solution to Problem 3.

PROFIT AND LOSS ACCOUNT

(Trading Section)

Purchases	50,000.00	Sales		40,000.00
Consignment Loss	1,600.00	Consignment Sales		5,000.00
Expenses	1,800.00	Loss on Trading		8,400.00
		A (½)	4,200.00	
		B (½)	4,200.00	
			8,400.00	
	53,400.00			53,400.00

A, Capital Account

Cash	3,500.00	Investment	16,000.00
B (Old debt)	3,500.00		
Net Loss (½)	4,200.00		
Balance	4,800.00		
	16,000.00		16,000.00
		Balance	4,800.00

B, Capital Account

Cash	1,500.00	Investment	2,000.00
Net Loss (½)	4,200.00	A (Old debt)	3,500.00
		Balance	200.00
	5,700.00		5,700.00
Balance	200.00		

Cash Account

A, Capital	16,000.00	A, Capital	3,500.00
B, Capital	2,000.00	B, Capital	1,500.00
Sales	40,000.00	Purchases	50,000.00
Consignment Sales	3,400.00	Expenses	1,800.00
B, Capital (Balance)	200.00	A, Capital (Balance)	4,800.00
	61,600.00		61,600.00

In the final settlement, A should get $4,600 in cash from the firm business and $200 from B.

The Cash account proves the correctness of the solution given above.

Problem 4. The following is a summary of the accounts upon dissolution of the partnership composed of A, B and C:

Debits		Credits	
A, Capital Account	$ 3,750.00	B, Capital Account	$ 35,000.00
Interest on Above, at 5%, accrued for 6 months	112.50	C, Capital Account	55,000.00
Assets	105,250.00	B, Loan Account	10,500.00
		Interest on Above, at 6%, accrued for 6 months	315.00
		Liabilities	27,500.00
	$109,112.50		$128,315.00

Adjust the partnership accounts and show the position of each partner after the liquidation.

Solution to Problem 4. The above accounts show

that a loss of $19,202.50 has been incurred in dissolving this firm. This loss must be divided equally between the three partners as there is no information that this loss should be divided in any other proportion. The Balance Sheet prepared after giving effect to this loss distribution will be as follows:

BALANCE SHEET

Assets		Liabilities	
A, Capital Account	$10,263.33	B, Capital Account	$28,599.17
Cash	77,750.00	C, Capital Account	48,599.16
		B, Loan Account	10,815.00
	$88,013.33		$88,013.33

The above Balance Sheet shows that A has a balance against him which he should pay into the firm if the Capital accounts of B and C are to be paid in full. If it should be that this debit balance cannot be collected for the benefit of the firm, the remaining two partners, B and C, must divide this loss between them. The balance of B's Loan account should be paid to B before any distribution of capital is made whatsoever.

The Capital accounts of the partners will appear as follows:

	A	*B*	*C*
Balances on dissolution date:			
Debits	$3,862.50	....	....
Credits	....	$35,000.00	$55,000.00
Loss on liquidation (⅓ each)	6,400.83	6,400.83	6,400.84
Balances adjusted:			
Debits	$10,263.33	....	....
Credits	....	$28,599.17	$48,599.16

§ 220. Dissolution by Death

Problem. A. J. Smith and J. D. Gray signed articles of copartnership January 1, 1895, each investing $30,000 and agreeing to share equally the profits and losses of a trading business. The copartnership was to exist for five years, and shortly after it terminated Smith died.

A trial balance of the accounts of the firm, taken January 1, 1900, was as follows:

A. J. Smith's drawing account	$35,746.00	A. J. Smith's capital	$30,000.00
J. D. Gray's drawing account	13,890.00	J. D. Gray's capital	30,000.00
Merchandise	35,000.00	Profit and loss	104,695.00
Horses and wagons	15,000.00		
Furniture and fixtures	5,000.00		
Cash	2,267.50		
Mortgages	10,000.00		
Bills receivable	8,000.00		
Accounts receivable	39,791.50		
	$164,695.00		$164,695.00

The surviving partner took possession of the merchandise, horses, wagons, furniture and fixtures, and continued business under his own name, at the same time acting as agent of the firm in realizing on the remaining assets. September 1, 1900, he reported to the executors of the estate of his late partner that he had collected $25,000.00 on open accounts, $5,000.00 on bills receivable and $1,650.00 for interest. His expenses had been as follows: Clerk hire, $500.00; lawyer's fees, $1,500.00; miscellaneous, $200, and he had made sundry allowances to customers amounting to $3,000.00.

Prepare statement showing the condition of the respective capital accounts September 1, 1900, and state what amount of cash is due from J. D. Gray to the estate of his late partner. Also prepare balance sheet for the same date. (C.P.A.)

Solution. The above Trial Balance indicates that all the nominal accounts have been merged in the item of Profit and Loss, the latter not as yet having been distributed to the partners' accounts. Likewise, the drawing accounts have not been closed into the partners' accounts. The first step, therefore, will be to prepare Journal entries to record these facts. They are as follows:

Profit and Loss	104,695.00	
To—A. J. Smith, Capital		52,347.50
J. D. Gray, Capital		52,347.50
To record distribution of profits in accord with partnership agreement		

A. J. Smith, Capital	35,746.00	
To—A. J. Smith, Drawing Account		35,746.00
To close		

J. D. Gray, Capital	13,890.00	
To—J. D. Gray, Drawing Account		13,890.00
To close		

After these entries have been posted, the accounts remaining on the books will permit the drawing of a Balance Sheet as of January 1, 1900.

The next step will be to show the fact by an entry that the surviving partner took possession of the merchandise, horses, wagons, furniture and fixtures, and continued business under his own name. The entry will be as follows:

J. D. Gray, Capital	55,000.00	
To—Merchandise		35,000.00
Horses and Wagons		15,000.00
Furniture and Fixtures		5,000.00
To record assets taken over by Gray		

The next step is to make entry of the facts as reported on September 1, 1900, concerning the liquidation activities up to and including August 31, 1900. When the interest of $1,650 was collected, the Cash account was charged and Income credited. This amount of income must now be distributed between the two partners, the entry being:

Income	1,650.00	
To—A. J. Smith, Capital		825.00
J. D. Gray, Capital		825.00

Likewise, after the adjustment of the income has been accomplished, it might be advisable next to consider the expense items incurred which must be shared equally by the two partners. The entries therefor would be:

A. J. Smith, Capital	1,100.00	
J. D. Gray, Capital	1,100.00	
To—Expenses		2,200.00
To record expenses paid for clerk hire, lawyers' fees, and miscellaneous as distributed against the two partners.		
A. J. Smith, Capital	1,500.00	
J. D. Gray, Capital	1,500.00	
To—Accounts Receivable		3,000.00
To record distribution of allowances made in collection of accounts		

After these above entries have been posted to the Ledger, it as an easy matter to prepare the statements called for and to determine how much cash is due from J. D. Gray to the estate of his late partner. To this end, the various Ledger accounts are shown first, followed by the required Balance Sheet.

Cash Account

1900			1900		
Jan. 1	Balance	2,267.50		Clerk Hire	500.00
	Accts. Rec.	25,000.00		Lawyers' Fees	Exp. 1,500.00
	Bills Rec.	5,000.00		Misc. Exp.	200.00
	Int. Income	1,650.00	Sept. 1	Balance	31,717.50
		33,917.50			33,917.50
Sept. 1	Balance	31,717.50			

Accounts Receivable

1900			1900		
Sept. 1	Balance	39,791.50		Cash	25,000.00
				Allowances	3,000.00
			Sept. 1	Balance	11,791.50
		39,791.50			39,791.50
Sept. 1	Balance	11,791.50			

Bills Receivable

1900			1900		
Jan. 1	Balance	8,000.00		Cash	5,000.00
			Sept. 1	Balance	3,000.00
		8,000.00			8,000.00
Sept. 1	Balance	3,000.00			

Income Account

1900			1900		
Sept. 1	A. J. Smith, Cap.	825.00			
	J. D. Gray, Cap.	825.00		Cash	1,650 .00
		1,650.00			1,650.00

Expense Account

1900			1900		
	Cash	500.00	Sept. 1	A. J. Smith, Cap.	1,100.00
	Cash	1,500.00		J. D. Gray, Cap.	1,100.00
	Cash	200.00			
		2,200.00			2,200.00

A. J. Smith, Capital

1900			1900		
Jan. 1	Drawings	35,746.00	Jan. 1	Investment	30,000.00
Sept. 1	Expenses	1,100.00		Net Profit	52,347.50
	Allowances	1,500.00	Sept. 1	Income	825.00
	Balance	44,826.50			
		83,172.50			83,172.50
			Sept. 1	Balance	44,826.50

J. D. Gray, Capital

1900			1900		
Jan. 1	Drawings	13,890.00	Jan. 1	Investment	30,000.00
	Merchandise	35,000.00		Net Profit	52,347.50
	Horses & W.	15,000.00	Sept. 1	Income	825.00
	Fur. & Fix.	5,000.00			
Sept. 1	Expenses	1,100.00			
	Allowances	1,500.00			
	Balance	11,682.50			
		83,172.50			83,172.50
			Sept. 1	Balance	11,682.50

Balance Sheet

September 1, 1900

Cash	31,717.50	A. J. Smith, Capital	44,826.50
Mortgages	10,000 00	J. D. Gray, Capital	11,682.50
Bills Receivable	3,000.00		
Accounts Receivable	11,791.50		
	56,509.00		56,509.00

In accord with the condition of this Balance Sheet, the estate of Smith should be paid all the cash there is on hand until the balance remaining in its favor is equal

to that payable to Gray. Then what is left may be divided equally.

At the time when Gray took over the affairs partially in the interest of the estate of Smith, the Capital account with Smith could have been replaced by the account of Estate of A. J. Smith. Likewise, although the problem uses the ending date as September 1, it would be just as correct in the solution to have used the ending date of August 31.

§ 221. Retiring Partner

Problem 1. A, B and C, partners, have made initial investments as follows: A, \$25,000, B, \$15,000, and C, \$10,000. Profits and losses are shared: A, 1/2, B, 3/10, and C, 1/5. During the first year a profit of \$7,500 was made. A withdraws from the firm. An allowance of \$1,250 is made for bad and doubtful accounts. B and C continue the business, paying A his share in cash. What entries are necessary to adjust and close the books in accord with the above?

Solution to Problem 1.

Profit and Loss	1,250.00	
To—Reserve for Bad and Doubtful Accounts		1,250.00
To record set up of allowance made for bad and doubtful accounts receivable		
Profit and Loss	6,250.00	
To—A, Capital		3,125.00
B, Capital		1,875.00
C, Capital		1,250.00
To record distribution of balance of profits in accord with agreement		
A, Capital	28,125.00	
To—Cash		28,125.00
To record payment to A to cancel his interest in the firm		

Problem 2. A and B, partners, dissolved partnership on May 31, 1918, B purchasing A's interest therein as shown by his Capital account on May 31, after due con-

sideration had been given to a re-valuation of the assets. A Balance Sheet of the firm on February 28, 1918, was as follows:

Assets		Liabilities	
Cash	$ 7,500.00	Accounts Payable	$ 25,000.00
Accounts Receivable (Bad debts and discounts provided for)	37,500.00	Notes Payable	7,500.00
Notes Receivable	5,000.00	Mortgage on Land and Buildings (4%)	37,500.00
Inventories	45,000.00	A, Capital	72,500.00
Tools	15,000.00	B, Capital	47,500.00
Plant and Machinery	30,000.00		
Land and Building	50,000.00		
	$190,000.00		$190,000.00

All profits and losses are divisible: A, 2/3, and B, 1/3. The result of the re-valuation as of May 31, was as follows: Inventories, $40,000; Tools, $17,500; Plant and Machinery, $28,000.00; Land and Buildings, $45,500. On this date, the other assets were found to be, and were agreed to, as follows: Cash, $10,000; Accounts Receivable (bad debts and discounts provided for), $42,-500; Notes Receivable, $3,000. On this same date, the liabilities were: Accounts Payable, $17,500; Notes Payable, $5,000.00; Mortgage as before, with interest paid to February 28, 1918. Prepare Balance Sheet as of May 31, 1918, giving effect to all factors mentioned above.

Solution to Problem 2. Before the Balance Sheet can be prepared, it is necessary to determine the net increase or decrease in the capital of each partner due to the adjustments that have taken place. The following statement will suffice:

Assets	*Increase*	*Decrease*
Cash	$ 2,500.00	
Accounts Receivable	5,000.00	
Notes Receivable		$ 2,000.00
Inventories		5,000.00
Tools	2,500.00	
Plant and Machinery		2,000.00
Land and Buildings		4,500.00
Totals	$ 10,000.00	$ 13,500.00

Liabilities		*Increase*	*Decrease*
Accounts Payable			$ 7,500.00
Notes Payable			2,500.00
Interest on Mortgage Unpaid		$ 375.00	
Totals		$ 375.00	$ 10,000.00
Summary			
Total Decrease in Asset Values		$ 13,500.00	
Total Increase in Liabilities		375.00	
Total Increase in Asset Values			$ 10,000.00
Total Decrease in Liabilities			10,000.00
Balance, Representing Net Increase in Capital.		6,125.00	
To be divided:			
A (⅔)	$ 4,083.33		
B (⅓)	2,041.67		
As above	$ 6,125.00		
		$ 20,000.00	$ 20,000.00

A & B

BALANCE SHEET

May 31, 1918

Assets		Liabilities	
Cash	$ 10,000.00	Accounts Payable	$ 17,500.00
Accounts Receivable	42,500.00	Notes Payable	5,000.00
Notes Receivable	3,000.00	Mortgage Interest Unpaid	375.00
Inventories	40,000.00		
Total Current Assets	$ 95,500.00	Total Current Liabilities	$ 22,875.00
Tools	$ 17,500.00	Mortgage on Land and Buildings (4%)	37,500.00
Plant and Machinery	28,000.00		
Land and Buildings	45,500.00		
		Total Liabilities	$ 60,375.00
		A, Capital	76,583.33
		B, Capital	49,541.67
Totals	$186,500.00	Totals	$186,500.00

B would have to pay A the balance shown in his Capital account; $76,583.33.

Problem 3. A firm of three partners with equal capital and interest operate for three years, when the Junior withdraws.

The partnership agreement provides that a retiring partner shall, in addition to his capital and share of

profits, receive by way of goodwill two years' purchase of his share of the average profits shown for the three years next preceding the date of withdrawal.

Make out a Balance Sheet, Profit and Loss account and an account with the retiring partner as of June 30, 1916, from the following memorandum handed to you with your instructions, on September 3, 1916, allowing for depreciation on plant account 5%, on leasehold account 15%, and for discount and possible loss on accounts receivable 10%.

The profits for the two previous years were respectively $69,330.00 and $78,450.00.

Capital	$ 63,000.00
Plant, Tools and Equipment	36,000.00
Leasehold	12,000.00
Merchandise Inventory, July 1, 1915 (net after deducting Reserve of $14,440)	13,000.00
Merchandise Inventory, June 30, 1916	20,000.00
Accounts Receivable	50,000.00
Accounts Payable	45,000.00
Merchandise Sales	150,000.00
Merchandise Purchases	72,000.00
Wages	12,000.00
General Expense	3,600.00
Bank	9,900.00
A's Drawing Account	14,100.00
B's Drawing Account	14,100.00
C's Drawing Account	14,100.00

The reserve against the Merchandise Stock which was of a very perishable nature was found in the final settlement of the accounts with the retiring partner not to be required. (C.P.A.)

Solution to Problem 3.

BALANCE SHEET

Exhibit 1.

June 30, 1916

Assets

Current Assets:			
Cash in Bank		$ 9,900.00	
Accounts Receivable	$ 50,000.00		
Less—Reserve for Bad Debts	5,500.00	45,000.00	
Merchandise Inventory		20,000.00	
			$ 74,900.00

Deferred Charges:			
Leasehold	$ 12,000.00		
Less—Depreciation	1,800.00	$ 10,200.00	
Unlocated Trial Balance Error		7,200.00	
			17,400.00
Plant, Tools and Equipment		$ 36,000.00	
Less—Reserve for Depreciation		1,800.00	
			34.200.00
Good will (Amount allowed retiring partner, see Exhibit 3)			46,351.11
Total Assets			$172,851.11

Liabilities and Capital

Current Liabilities:		
Accounts Payable	$ 45,000.00	
Amount Due Retiring Partner (See Exhibit 4)	73,517.78	
Total Current Liabilities		$118,517.78
Capital:		
A	$ 27,166.67	
B	27,166.66	
		54,333.33
Total Liabilities and Capital		$172,851.11

Statement of Profits and Income
Year Ended June 30, 1916

Exhibit 2.

Merchandise Sales		$150,000.00
Deduct—Cost of Goods Sold (See Exhibit 5)		95,040.00
Balance, Gross Profits		$ 54,960.00
Deduct—General and Administrative Expenses		
General Expenses	$ 3,600.00	
Provision for Bad Debts	5,000.00	
		8,600.00
Balance, Net Profits Year Ended June 30, 1916		$ 46,360.00
Add—Inventory Reserve, July 1, 1915, written back		14,440.00
Balance, Surplus Net Profits		$ 60,800.00

Statement Showing Determination of Goodwill

Exhibit 3.

Profits for the Year Ended June 30:		
1914	$ 69,330.00	
1915	78,450.00	
1916	60,800.00	
		$208,580.00
Average for Each Year		$ 69,526.67
Two Years' Purchase of Average		$139,053.34
Junior Partner C's Share (1/3)		$ 46,351.11

Statement of Account
with
Retiring Junior Partner C

Exhibit 4.

Balance as at June 30, 1916, Goodwill and Drawings Excluded		$ 21,000.00
Add—Two Years' Purchase of Goodwill (Exhibit 3)	$ 46,351.11	
Proportion of Surplus Net Profits for Year	20,266.67	
		66,617.78
Total		$ 87,617.78
Deduct—Withdrawals		14,100.00
Balance as at June 30, 1916, per Balance Sheet adjusted		$ 73,517.78

Statement of Cost of Goods Sold
Year Ended June 30, 1916

Exhibit 5.

Inventory, July 1, 1915		$ 27,440.00
Purchases		72,000.00
Wages		12,000.00
Depreciation on:		
Plant, Tools and Equipment	$ 1,800.00	
Leasehold	1,800.00	
		3,600.00
Total		$115,040.00
Deduct—Inventory, June 30, 1916		20,000.00
Total Cost of Goods Sold		$ 95,040.00

The inventory reserve of $14,440, was created out of the profits of the past three years. Therefore, since it is no longer required, the Profit and Loss account may be credited therefor, as of that period.

§ 222. Disposal of Business: Dollar for Dollar

Problem. James Hewson and Walter Fellows had been in partnership for several years, and at December, 1909, desiring to retire, they entered into an arrangement to dispose of their business to William Jones, on the general terms that he, Jones, should take over everything as it then stood, subject to the following conditions, viz.:

1. Inventory of Merchandise to be subject to a rebate of 6%
2. Accounts Receivable to have a deduction of 7½%, to meet possible losses.
3. Office Furniture to be subject to a deduction of 12½% for depreciation
4. Liabilities to creditors to be discharged by the 1st of February.

On the exact amount required to be paid over to the parties by Jones being ascertained, he was to pay one-fourth in cash on February 4th, and the balance by equal installments, giving his notes for the same which are paid in cash as they fall due, dating from January 1st, at three, six and nine months, such installments to carry interest at 5% per annum.

The inventory of Merchandise in hand amounted to $21,800.00, the Accounts Receivable to $18,200.00, and the Office Furniture stood on the books at $1,250. The sums due to creditors amounted to $6,250.00.

You are asked, as representing Jones, to prepare the Ledger Accounts as they will have recorded and given effect to the foregoing arrangement in Jones' Ledger. (C.P.A.)

Solution. The following Ledger accounts are presented as a solution to the above problem. No Reserve accounts are shown except for Bad Debts. The Inventory and Office Furniture accounts record net values taken over. But since it is doubtful just how much, or what Accounts Receivable are actually bad, a Reserve account is made use of rather than to carry the value net. The accounts as shown indicate the payment by Jones of all obligations as they fall due. The Ledger accounts are as follows:

Inventory of Merchandise

Taken over from H. & F..	$20,492.00

Accounts Receivable

Taken over from H. & F..	$18,200.00		

Reserve for Bad Debts

		Reserve for Possible Loss	$ 1,365.00

Office Furniture

Taken over from H. & F..	$ 1,093.75		

Accounts Payable

Cash Payments	$ 6,250.00	Taken over from H. & F..	$ 6,250.00

Notes Payable

Cash Payments	$ 8.042.69	4/1 Issued to H. & F. (1910)	$ 8,042,69
Cash Payments	8,042.69	7/1 Issued to H. & F. (1911)	8,042.69
Cash Payments	8,042.69	10/1 Issued to H. & F. (1911)	8,042.69
	$24,128.07		$24,128.07

Interest on Notes Payable

Cash Payments	$ 100.54	Balance	$ 703.21
Cash Payments	201.08		
Cash Payments	301.59		
	$ 703.21		$ 703.21

Cash

Capital	$ 6,250.00	Accounts Payable	$ 6,250.00
Capital	8,042.68	H. & F., Vendor	8,042.68
Capital	8,143.23	Notes Payable of 4/1	8,042.69
Capital	8,243.77	Interest on above	100.54
Capital	8,344.28	Notes Payable of 7/1	8,042.69
		Interest on above	201.08
		Notes Payable 10/1	8,042.69
		Interest on above	301.59
	$39,023.96		$39,023.96

H & F—Vendor Account

Cash Payments	$ 8,042,68	Net Assets taken over	$32,170.75
Notes Payable	$24,128.07		
	$32,170.75		$32,170.75

Jones, Capital Account

Balance	$39,023.96	Cash	$ 6,250.00
		Cash	8,042.68
		Cash	8,143.23
		Cash	8,243.77
		Cash	8,344.28
	$39,023.96		$39,023.96

§ 223. Disposal of Business: Realization and Liquidation.

Problem 1. A and B, on winding up their partnership, found their assets realized as follows:

> Factory premises standing in their books at \$10,000, realized \$4,000.
>
> Machinery standing in their books at \$7,500, realized \$2,500
>
> Merchandise standing in their books at \$5,500, realized \$4,500
>
> Accounts receivable standing in their books at \$9,500, realized \$6,500

Their unpaid liabilities were \$10,500. A's capital stood at \$15,000, and B's capital at \$7,000. In respect of Profits and Losses, they were equal partners.

Divide the proceeds of the realization between them after paying off the liabilities, and debit them as having been paid the proportion to which each man was entitled, and show what amount would be payable (if any) by either partner to the other to settle the accounts. (C.P.A.)

Solution to Problem 1. The first thing to do would perhaps be the preparation of a Trial Balance. It is as follows:

Trial Balance

Factory Premises	\$10,000.00	Accounts Payable	\$10,500.00
Machinery	7,500.00	A, Capital	15,000.00
Merchandise	5,500.00	B, Capital	7,000.00
Accounts Receivable	9,500.00		
	\$32,500.00		\$32,500.00

The second step would be to prepare a Realization and Liquidation Statement. The following is an illustration of such a statement:

Statement of Realization and Liquidation

Assets to be Realized:		Liabilities to be Liquidated:	
Factory Premises	$10,000.00	Accounts Payable	$10,500.00
Machinery	7,500.00	Assets Realized:	
Merchandise	5,500.00	Factory Premises	4,000.00
Accounts Receivable	9,500.00	Machinery	2,500.00
Liabilities Liquidated:		Merchandise	4,500.00
Accounts Payable	10,500.00	Accounts Receivable	6,500.00
		Loss on Liquidation	15,000.00
	$43,000.00		$43,000.00

The loss on the liquidation would be shared equally by the two partners, and a Journal entry should be made to take such loss up into their Capital accounts.

The Capital accounts would now appear as follows:

A, Capital Account

Liquidation Loss	$ 7,500.00	Investment	$15,000.00
Balance	7,500.00		
	$15,000.00		$15,000.00
		Balance	$ 7,500.00

B, Capital Account

Loss on Liquidation	$ 7,500.00	Investment	$ 7,000.00
		Balance	500.00
	$ 7,500.00		
Balance	$ 500.00		$ 7,500.00

Balance Sheet

Cash	$ 7,000.00	A, Capital	$ 7,500.00
B, Capital	500.00		
	$ 7,500.00		$ 7,500.00

The above Balance Sheet shows that A is entitled to all the cash on hand, and that, in addition, he has a claim against B in the amount of $500. In the above solution, the Cash account has been omitted, having been considered unnecessary.

Problem 2. The firm of Ward & Gneisel decide to dissolve and wind up the affairs of the partnership. They have assets as follows: Real estate, $27,622.92; machinery and equipment, $19,132.84; patents, $3,985;

accounts receivable, \$29,716.42. Their liabilities are: Notes payable, \$16,000; Accounts payable, \$8,693.15. The Capital accounts are: Ward, \$32,001.03; Gneisel, \$23,763.00.

Upon sale, the assets realized as follows: Real estate, \$26,000; machinery and equipment, \$13,750; patents, \$18,300; accounts receivable, \$25,617.42. All the booked liabilities were paid; an unrecorded liability in the amount of \$2,343.78 also was paid.

For the above, prepare all the entries necessary, the Realization and Liquidation account, and a statement showing the final adjustment between the partners.

Solution to Problem 2. The entries for the above are as follows:

Realization and Liquidation Account		\$ 80,457.18	
To—Real Estate			\$ 27,622.92
Machinery and Equipment			19,132.84
Patents			3,985.00
Accounts Receivable			29,716.42
To transfer assets to be sold to the realization and liquidation account.			
Notes Payable		\$ 16,000.00	
Accounts Payable		8,693.15	
To—Realization and Liquidation Account			24,693.15
To record liabilities to be discharged through realization and liquidation account.			
Cash		83,667.42	
To—Realization and Liquidation Account			83,667.42
To record cash received from sale of assets and collection of accounts receivable, as follows:			
Real Estate	\$ 26,000.00		
Machinery and Equipment	13,750.00		
Patents	18,300.00		
Accounts Receivable	25,617.42		
	\$ 83,667.42		
Realization and Liquidation Account		27,036.93	
To—Cash			27,036.93
To record payment of liabilities as:			
Notes Payable	\$ 16,000.00		
Accounts Payable	8,693.15		
Booked Liabilities	\$ 24,693.15		
Unrecorded Liability	2,343.78		
	\$ 27,036.93		

Realization and Liquidation Account	$ 866.46		
To—Ward, Capital		$	433.23
Gneisel, Capital			433.23
To record distribution of net profit on liquidation to the partners.			

Realization and Liquidation Account

Assets to be Realized:		Liabilities to be Liquidated:	
Real Estate	$ 27,622.92	Notes Payable	$ 16,000.00
Machinery and Equipment	19,132.84	Accounts Payable	8,693.15
Patents	3,985.00		
Accounts Receivable	29,716.42		
Total	$ 80,457.18	Total	$ 24,693.15
Liabilities Liquidated	27,036.93	Assets Realized	83,667.42
Balance, Net Profit on Realization and Liquidation, chargeable to partners:			
Ward $ 433.23			
Gneisel 433.23	866.46		
	$108,360.57		$108,360.57

Summary of Partners' Accounts

	Ward	*Gneisel*	*Both*
Balance, per books	$ 32,001.03	$ 23,763.00	$ 55,764.03
Add—Net Profit on Realization and Liquidation	433.23	433.23	866.46
Balance, amounts due each partner at close of Realization and Liquidation	$ 32,434.26	$ 24,196.23	$ 56,630.49

The amount of cash on hand should be equal to $56,-630.49, which amount should be distributed between the two partners in accord with the balances of their Capital accounts.

§ 224. Installment Distribution

Problem 1. A and B are partners, sharing profits and losses A 2/3, and B 1/3. The firm dissolves. A's Capital account has a credit balance of $63,000, and B's Capital account a credit balance of $27,000.00. $12,000 is collected and is distributed as the first liquidating

dividend. The rest of the assets are worthless. How would the $12,000 be divided between A and B, and how would the loss be apportioned among the two partners?

Solution to Problem 1. The solution to the above problem is set out in the following tabulation:

	Total	*A*	*B*
Capital Account Balances	$ 90,000.00	$ 63,000.00	$ 27,000.00
First Dividend	12,000.00	11,000.00	1,000.00
Balances	$ 78,000.00	$ 52,000.00	$ 26,000.00
Loss	78,000.00	52,000.00	26,000.00

Overpayments can be avoided by making the first payments in such amounts as will reduce the partners' Capital accounts to the profit and loss sharing ratio. The first dividend was $12,000. After this dividend has been paid, there will be left total assets remaining of $78,000. 2/3 of $78,000 is $52,000, and 1/3 of $78,000 is $26,000. The $12,000 must be divided so that after its payment, the Capital accounts will be to each other in the same ratio as the profit and loss sharing ratio, A 2/3, and B 1/3. Therefore, A should receive $11,000, and B $1,000.

The loss of $78,000 would be distributed as per the Capital account balances.

Problem 2. A, B and C entered into partnership on the terms that A was to have a ½ share of the profits, and B and C, each a ¼ share. When the partnership was dissolved, the financial position of the firm was as follows:

Sundry Assets	$ 20,000.00	Accounts Payable	$ 7,000.00
		A, Capital	5,000.00
		B, Capital	5,000.00
		C, Capital	3,000.00
	$ 20,000.00		$ 20,000.00

The assets realized $17,000, and this was received in installments as follows: $7,000; $5,000; $5,000. How

should the proceeds of the assets be applied, as and when received?

Solution to Problem 2. The outside creditors should be paid off first. The first installment suffices for this purpose. All subsequent receipts are available for distribution among the partners inter se. The distribution of the liquidating dividends is as follows:

	Total	*A*	*B*	*C*
Capital Account Balances.........	$ 13,000	$ 5,000	$ 5,000	$ 3,000
Dividend No. 1..................	5,000	1,000	3,000	1,000
Balances	8,000	4,000	2,000	2,000
Dividend No. 2..................	5,000	2,500	1,250	1,250
Balances	3,000	1,500	750	750
Loss	3,000	1,500	750	750

After dividend No. 2 has been paid, there will still remain $1,500 to the credit of A, $750 to the credit of B, and $750 to the credit of C. The Capitals, at this point, are seen to be in accord with the profit and loss sharing ratio. Since no further assets remain to be realized upon, these amounts represent the losses respectively sustained by the partners, which, it will be noticed, are in the correct ratios.

CHAPTER XII

SELLING AGENCY AND BRANCH ACCOUNTS

§ 225. Introduction

When a business is located at a distance from the trade centers in which it has many customers, it may establish in such centers agencies or branches. By so doing, business will be better promoted and protected than from the main office. Contact with each customer is more easily made from a near branch or agency than from a distant home office. Again, a saving in transportation costs may follow such establishment. Goods are sent out by the home office in carload lots instead of in small packages; the carload rate will be much less than the total charges necessitated by sending the same goods in small units to customers direct. The small units are sent to the customer from the agency or branch instead of from the home office.

§ 226. Agency Accounts

An agency is merely a salesman for the home office. It does not pass upon credits, or collect the accounts it secures. Whenever a sale is made, a copy of each order is sent to the home office, in which place it is handled exactly as if a salesman had sent in the order.

Agency accounts require but slight explanation. Since an agency collects no money from customers, it has no funds to use for paying current expenses except those furnished by the home office. Money sent out to an agency is handled upon the principle of a petty cash

fund, except that being greater in amount it is designated usually by the title of "working fund." When such fund is established, the entries in the home office would be:

Agency Working Fund ....$¢
To—Cash ....$¢

Only one other account is needed, that of Agency Expense. To this account are charged the checks issued payable out of the working fund.

§ 227. Branch Accounts

The home office of an enterprise may have a number of branches. When such is the case, certain bookkeeping problems are met with which are uncommon to ordinary experience. Some concerns must have many branches in order to exist. Each branch will have its own system suited to its needs. Such cases are not considered in the present discussion. At present, the discussion centers around a business which is carried on in a number of places. In such case, the branch may practically be the business, as where the home office consists of but a place at which the directors meet and at which certain records are kept. Again, in such case, there may be a business which is carried on mostly in one place but for some reason or other has a small representative stationed in some other place. Again, the branch may sell but not purchase anything. Again, the branch may purchase but not sell anything. Lastly, the branch may both buy and sell in a manner similar to that of the home office.

§ 228. Branch Control

There are all sorts of branches and, also, there are numerous ways of controlling them. The branch may

furnish no information at all to the home office during an accounting period, except that at its end an annual Balance Sheet is submitted to the home office, accompanied by a Statement of Profit and Loss. Again, the home office may require the branch to forward duplicates of every entry made upon the branch books. These two illustrations indicate the two extremes; between them the variations encountered are without number.

Because of such great variation, the major principle to be presented here is how to use the double entry principle in connection with branch accounts—accounts of all kinds.

§ 229. Independent Branch which Purchases and Sells

Money is sent by the home office in New York City to a branch manager located in St. Paul, say, $100,000. So far as we are concerned, the branch might be located in China or South America; the location is immaterial. This manager is to erect a factory. If the branch were a foreign one, it would be necessary to consider the questions of foreign money and exchange. In the present discussion, such questions may be entirely disregarded, since they do not in any way affect the basic principles. On the home office books an account "St. Paul Branch" would be opened, and this account would be debited with the amount of the $100,000. The branch at St. Paul would open a set of records for the various activities engaged in, containing a complete list of the accounts required.

At the end of the year, after the factory is erected and equipped, the home office books will show a debit balance in the "St. Paul Branch" account of $100,000. The branch books will show a credit balance of a similar amount in an account of Home Office. The branch Balance Sheet may look about as follows:

ST. PAUL BRANCH OF............

Balance Sheet

December 31, 1917

Assets		Liabilities	
Cash	$ 2,000.00	Home Office	$100,000.00
Machinery & Equipment	13,000.00		
Land and Building	85,000.00		
	$100.000.00		$100.000.00

When the home office constructs its Balance Sheet, the $100,000 debit

1. May be carried in the one account, the asset account of St. Paul Branch, or
2. It may be resolved into its constituent parts, a Journal entry being made debiting accounts opened for the various items and crediting (and closing) the account with the branch.

The first method is the simpler of the two, and usually is the one made use of. The St. Paul Branch account shows how much money there is at that place, and the books at St. Paul show how such amount is made up.

At all times, it would be advisable for the student, in connection with the discussion of branch accounts, to keep in mind the principles underlying the use of controlling accounts; practically this is what we are attempting to set up,—the control account on the home office books to equal a similar control account kept on the branch books.

§ 230. Disposal of Profit in Above Case

Assume that the St. Paul branch enterprise grows and prospers, and that during the next year $25,000 more is sent out to it by the home office. The branch earns a profit of $15,000. The home office books will show a debit balance of $125,000 in the branch account, and the branch books will show a credit balance of $125,000 in

the home office account. At this point, the branch Balance Sheet may appear about as follows:

ST. PAUL BRANCH OF............

Balance Sheet

December 31, 1918

Assets		Liabilities	
Cash	$ 2,500.00	Accounts Payable	$ 25,000.00
Accounts Receivable	35,000.00	Home Office	125,000.00
Merchandise Inventories	30,000.00	Profit and Loss	15,000.00
Machinery and equipment	12,500.00		
Land and Building	85,000.00		
	$165,000.00		$165,000.00

The disposal of the profit item of $15,000 is the question now to be decided. Profit represents the increase in net assets at the end of the year over their amount at the beginning of the year. This increase belongs to the home office—the same as if the home office had sent $15,000 to the branch. Therefore, on the branch books, the profit item of $15,000 should be disposed of by transferring it to the Home Office account, the latter after such step being $140,000. On the home office books, the item would be debited to the branch account and be credited to Profit and Loss. The branch account on the home office books now stands at a $140,000 balance, also. At this time the home office Balance Sheet would probably, in its final form, take up the liabilities of $25,000 and the assets of $165,000, instead of showing one sum of $140,000 as an asset.

§ 231. Home Office Purchasing for Branch in Above Case

The above illustration is simple, because the branch acts independently in purchasing and selling. The further away a branch is located from the home office, the simpler, in general, will be its bookkeeping problems. Policy, in such case, may easily be controlled, but to control the details is a difficult task.

Even in such an independent case as has been cited, the home office, from time to time, will purchase a few things for the branch. When the account is paid, the home office debits the branch as if cash were being remitted thereto, and the branch office credits the account with the home office on its books debiting the account or accounts concerned with the purchase.

If the branch supplies a customer with goods, and this customer pays the home office the amount involved, the home office should credit the branch as if the latter had remitted cash; and the branch should debit the home office and credit the customer. (The assumption here is, naturally, that in the first instance, the branch debited the customer's account and credited Sales account.)

§ 232. Home Office Purchasing Regularly for Branch

For the next illustration, assume the home office is located in New York City and the branch office in South Bend, Indiana. The goods for the South Bend branch are ordered from, and are invoiced to, the home office, but delivered to the branch. All cash collected by the branch is deposited intact for remittance to the home office, there to be credited to the account with the home office.

In this case, the Purchase Ledger would be kept in New York and the Sales Ledger in South Bend. (At least the original Sales Ledger would be kept at South Bend, even though a duplicate may be kept in New York.) The accounting system used under these conditions would not be uniform,—one accountant would handle the matter one way, another accountant would handle the matter in a different way. Therefore, bookkeeping principles are considered only, so that a satisfactory result may be secured.

On the home office records, one account would suffice for handling all transactions between the two places, and yet because of the many transactions a number of accounts would be more satisfactory than just one. These many accounts, at the end of each year, could be closed into one account representing the branch capital. Assume $50,000 has been sent by the home office to the branch, in the first instance, for starting the business. Such amount, on the home office books, would be debited to the Branch Capital account.

The purchases made by the home office for the branch may be kept either in a separate purchase record or may be given a special column in the general purchase record. The latter method is preferable. The total of this separate column would be debited to South Bend Branch Purchases account. These purchases are assumed to amount to $100,000.

All cash deposited by the branch for the home office remittances would be entered in the home office Cash Book as being received from the branch, the credit being to South Bend Branch Current account. This cash is assumed to amount to $90,000.

The expenses of the South Bend branch will be paid from remittances sent its manager by the home office. These remittances are passed through the home office Cash Book, being debited to the account of South Bend Branch Expenses. Assume this amount to be $15,000. (An alternative method would be for the branch manager to send the home office a weekly statement of expenses to be paid, and have the home office remit to him a check for the exact amount.)

The branch Ledger will contain a Home Office Capital account, holding a credit balance of $50,000, offset by certain debits to the accounts with merchandise stock, and furniture and fixtures. (Assume there are these

two accounts with balances at the beginning of the year, say, \$40,000, and \$10,000, respectively.) Likewise, there will be a Home Office Purchases account with a credit balance of \$100,000, a Home Office Current account with a debit balance of \$90,000, and a Home Office Expenses account with a credit balance of \$15,000.

A Sales Book and a Sales Ledger may be kept as in any other business. The Cash Book may be in two parts, a Receipts Register and an Operating Cash Book. The Receipts Register records receipts from customers. Customers' receipts, it should be remembered, are deposited to the credit of the home office. Therefore, a separate Cash Book may well be kept for this purpose alone, its ruling being about as follows:

Ledger Folio
Total
Discount
Cash Received
Deposits

The balance of \$85,000 in the Capital account is the item found in the branch Balance Sheet. The Balance Sheet may be as below:

SOUTH BEND BRANCH

Balance Sheet

Accounts Receivable	\$ 40,000.00	Home Office	\$ 85,000.00
Merchandise	35,000.00		
Furniture & Fixtures	10,000.00		
	\$ 85,000.00		\$ 85,000.00

On the home office books, there is the Branch Capital account to be considered. This account, when the branch accounts have been received, should contain exactly the same items as the corresponding account in the branch books, but in this case (case of home office) they will be on the opposite side.

The entry on the home office books for the profit as

shown on the branch books is secured by debiting the Branch Capital account and crediting the general Profit and Loss account.

The two sets of books, kept independently, as suggested, are ultimately brought into harmony one with the other. The discussion above is brief only, and the assumptions are very simple in nature. Depreciation, bad debts, direct liabilities of branch, etc., have not been considered.

The above discussion of branch accounts should be sufficient to show the principles underlying them. These principles, once understood, can be applied to any given case.

The second Cash Book records merely the amounts received from the home office for expense purposes and their disposal. The amounts received constitute the only debits; the payments are posted to the Ledger accounts (expense accounts) in the ordinary manner.

The branch Statement of Profit and Loss, in account form, very simply, may be as follows:

SOUTH BEND BRANCH
Profit and Loss Account

Beginning Inventory	$ 40,000.00	Sales	$130,000.00
Purchases	100,000.00	Ending Inventory	35,000.00
Expenses	15,000.00		
Balance, Profit	10,000.00		
	$165,000.00		$165,000.00

The profit of $10,000 must be credited to the Home Office Capital account. This Capital account, at the end of the year, will assume about the following appearance:

Home Office Capital Account

19—			19—		
Dec. 31	Current Account	$90,000.00	Jan. 1	Balance	$ 50,000.00
	Balance	85,000.00	Dec. 31	Purchases	100,000.00
				Expenses	15,000.00
				Profit for Year	10,000.00
		$175,000.00			$175,000.00
			Jan. 1	Balance	$ 85,000.00

§ 233. Illustrative Problems in Branch Accounts

Problem 1. The following problem and its solution shows one way in use of handling branch accounts. It should be noticed that the branch keeps the accounts with its customers and creditors. Likewise, it is seen that the branch itself purchases part of its merchandise, and that part of it is secured from the home office for which a separate transfer account is carried as branch sales are not regular sales (sales from home office to the branch). A Home Office account is carried upon the branch books and a Branch account is carried on the home office books; of necessity, these two accounts must show the same balances, but on opposite sides. In preparing the statements of the business as a whole, the two Trial Balances must first be combined, the statements being prepared therefrom. The ending inventory is known only by the home office; therefore, it would not be possible to prepare a Statement of Profits and Income for the branch, unless the home office itself wished to do so. As a rule, it is good policy to keep branch managers in ignorance of the actual amount of profit they have earned. The problem is as follows:

On December 31, 1919, a Trial Balance taken from the home office books of the Enterprise Manufacturing Company was as follows:

Cash	$ 1,000.00	
Accounts Receivable	4,000.00	
Inventory, Factory, January 1, 1919	1,700.00	
Inventory, Branch, January 1, 1919	700.00	
Factory Buildings	10,000.00	
Branch Account	300.00	
Accounts Payable		$ 3,000.00
Capital Stock		10,000.00
Purchases	3,000.00	
Sales		6,000.00
Branch Transfers		2,500.00
Expenses	800.00	
	$ 21,500.00	$ 21,500.00

A Trial Balance taken from the branch books on the same date was as follows:

Cash	$ 200.00	
Accounts	2,000.00	
Home Office		$ 300.00
Accounts Payable		700.00
Sales		5,300.00
Purchases	1,400.00	
Home Office Transfers	2,500.00	
Expenses	200.00	
	$ 6,300.00	$ 6,300.00

Inventories on December 31, 1919, were:

Home Office	$ 1,500.00
Branch	1,000.00

Required:

1. Journal entries to adjust both sets of books.
2. Profit and Loss Statement and closing Balance Sheet for the entire concern.

Omit estimate for depreciation.

Solution to Problem 1. The first thing to do is to prepare what might be called a combined Trial Balance from the two sets of books. This would be done by listing all the items along the left side of a sheet and then by placing their amounts in columns to the right, six of them, headed as follows: Home Office Books—Dr. and Cr.; Branch Books—Dr. and Cr.; Together—Dr. and Cr. The figures in the last two columns are the ones needed. They are as follows:

ENTERPRISE MANUFACTURING COMPANY

Combined Trial Balance

December 31, 1919

Cash	$ 1,200.00	
Accounts Receivable	6,000.00	
Inventory	2,400.00	
Factory Buildings	10,000.00	
Branch Account	300.00	
Home Office		$ 300.00
Accounts Payable		3,700.00
Capital Stock		10,000.00
Purchases	4,400.00	
Transfers to Branch		2,500.00

Transfers from Home Office	$ 2,500.00	
Sale		$ 11,300.00
Expenses	1,000.00	
	$ 27,800.00	$ 27,800.00

The next step would be to prepare the Journal entries necessary to adjust both sets of books and close them. The entries are as follows:

On the Branch Books

Sales	$ 5,300.00	
To—Purchases		$ 1,400.00
Expenses		200.00
Transfers from Home Office		2,500.00
Home Office		1,200.00
To record closing of the nominal accounts into the Home Office account.		

On the Home Office Books

Inventory (new)	$ 2,500.00	
Transfers to Branch	1,200.00	
Sales	6,000.00	
Branch Office	1,200.00	
To—Inventory (old)		2,400.00
Purchases		3,000.00
Expenses		800.00
Profit and Loss		6,000.00
To record closing of the nominal accounts and to show the effect of the closing entries of the branch books on the general records at the Home Office.		

We are now in a position to prepare the consolidated statements of the enterprise, the Balance Sheet and the Statement of Profits and Income.

ENTERPRISE MANUFACTURING COMPANY

Consolidated Balance Sheet

December 31, 1919

Assets

Cash	$ 1,200.00
Accounts Receivable	6,000.00
Inventories	2,500.00
Factory Buildings	10,000.00
Total Assets	$ 19,700.00

Liabilities and Capital

Accounts Payable	$ 3,700.00
Capital Stock	10,000.00
Surplus, representing profits for 1919	6,000.00
Total Liabilities and Capital	$ 19,700.00

ENTERPRISE MANUFACTURING COMPANY

Consolidated Statement of Profits and Income

Year Ended December 31, 1919

Sales		$ 11,300.00
Less—Cost of Sales:		
Beginning Inventory, January 1, 1919	$ 2,400.00	
Add—Purchases for Year	4,400.00	
Cost of Goods Handled	$ 6,800.00	
Less—Ending Inventory, December 31, 1919	2,500.00	4,300.00
Gross Profit		$ 7,000.00
Less—Expenses		1,000.00
Net Profit for Year, increase in Surplus		$ 6,000.00

Problem 2. The following statements were prepared from the books of the Home and Branch Offices, respectively, of a certain company, and show the inter-office transactions as recorded upon the books kept at each office:

Home Office Books

Branch Office—Current Account

Debits		Credits	
Balance, per last statement rendered	$ 21,150.13	Balance, end of period	$ 30,579.98
Cash	4,500.00		
Advances to branch manager for miscellaneous expense	625.00		
Merchandise shipped to branch	3,314.18		
Taxes and other expenses paid account of branch	990.67		
	$ 30,579.98		$ 30,579.98

Branch Office Books

Home Office—Current Account

Debits		Credits	
Miscellaneous charges, Insurance, postage, etc. during period chargeable to home office	$ 519.23	Balance, per last statement rendered	$ 21,150.13
Payment of an account payable for material purchased by home office	5,500.00	Taxes and other expenses paid by home office	990.67
Balance, end of period	28,851.01	Balance, Profit and Loss	12,729.44
	$ 34,870.24		$ 34,870.24

Required:

1. Reconciliation statement for the two current accounts.
2. Entries to bring the two accounts into agreement.
3. The two current accounts in agreement.

Solution to Problem 2. In solving this problem, the first thing to do is to find the difference existing between the two above accounts. The next step, following this, would be to account for such difference. These two steps are shown in the reconciliation statement below. The third step covers making the entries for both sets of books to bring them into agreement, one with the other; the fourth step is to show the two current accounts in agreement.

STATEMENT OF RECONCILIATION

Home Office and Branch Office

Balance, per home office books		$ 30,579.98
Balance, per branch office books		28,851.01
Difference, to be accounted for, being net debits of home office not shown as credited by branch office		$ 1,728.97
Home office debits not credited by branch office:		
Cash advanced	$ 4,500.00	
Advances to branch manager	625.00	
Merchandise shipped, in transit, not received	3,314.18	
		$ 8,439.18

Branch office debits not credited by home office:		
Miscellaneous charges, insurance, etc. ....$ 519.23		
Payment of account payable for material purchased............. 5,500.00		6,019.23
Branch office credits not debited by home office:		
Profit and loss account balance................	$ 12,729.44	
Balance, net debits of home office not shown as credited by branch office, as above..........	1,728.97	
Totals	$ 14,458.41	$ 14,458.41

Journal Entries

To bring books into agreement

Home Office Books

1. Accounts Payable (Control)..................	$ 5,500.00	
Miscellaneous Charges	519.23	
To—Branch Office, Current Account.........		$ 6,019.23
To record charges of branch office not entered by home office; see last current account.		
2. Branch Office, Current Account...............	12,729.44	
To—Profit and Loss, Branch Office........		12,729.44
To record profits of branch as shown by current account and attached Statement of Profit and Loss.		

Branch Office Books

1. Cash	4,500.00	
Advances to Branch Manager.................	625.00	
Merchandise Purchases......................	3,314.18	
To—Home Office, Current Account..........		8,439.18
To record charges of home office not entered by branch office.		

When these entries have been made and posted, the two current accounts will be in agreement, as follows:

Home Office Books

Branch Office—Current Account

Debits		Credits	
Balance, per last statement submitted.......$	21,150.13	Payment of an account payable for material purchased by home...$	5,500.00
Cash	4,500.00	Miscellaneous charges, insurance, etc., during period, chargeable to home office...........	519.23
Advances to branch manager for miscellaneous expense	625.00	Balance, end of period...	37,290.19
Merchandise shipped to branch	3,314.18		
Taxes and other expenses account of branch....	990.67		
Profit and Loss, Branch.	12,729.44		
	$ 43,309.42		$ 43,309.42

Branch Office Books

Home Office—Current Account

Debits		Credits	
Payment of an account payable for material purchased by home office	$ 5,500.00	Balance, per last statement submitted	$ 21,150 13
Miscellaneous charges, insurance, etc., during period, chargeable to home office	519.23	Cash	4,500.00
Balance, end of period...	37,290.19	Advances to branch manager for expenses.....	625.00
		Merchandise shipped to branch	3,314.18
		Taxes and other expense paid account of branch	990.67
		Profit and Loss, Branch.	12,729.44
	$ 43,309.42		$ 43,309.42

Problem 3. Two men carry on a business together as partners at New York and Chicago, each having sole control of one branch. The partnership agreement specifies that the New York partner was to have a salary of $5,000 a year, while the Chicago partner was to have $2,000 a year and one-fourth of the remaining profits of that branch, after salary deducted. Five per cent. interest was to be allowed on the capital used in the business, $300,000, which was to be employed 3/5 at New York and 2/5 at Chicago. The repairs and renewals were to be charged to plant and buildings, and a depreciation of 5 per cent. per annum was to be allowed. Interest on borrowed money and other charges, amounting to $6,800, were to be charged against each branch, 3/5 and 2/5, respectively. The Plant and Buildings account at the beginning of the year shows the following balances: New York, $225,000; Chicago, $175,000. Repairs and renewals during the year were: New York, $20,000; Chicago, $15,000. The profits for the year, subject to the consideration of these various charges, were: New York, $50,000; Chicago, $40,000. Complete the Profit and Loss account for the year for each branch.

Solution to Problem 3. Before attempting to solve a problem, it is necessary to make sure that all the factors

therein contained are thoroughly understood, or at least that a definite understanding has been reached as to how they will be handled in the solution. In the above problem, two items demand consideration before a solution should be attempted; namely, repairs and renewals and depreciation. We are told that the item of repairs and renewals is to be charged to plant and buildings. By so doing, with no explanation to the contrary, we would be capitalizing a revenue expenditure; this, naturally, is entirely wrong. Again, depreciation is an operating expense and, as such, ought not to appear in connection with the other items given which have to do with the financial and the appropriation sections of the Profit and Loss account. Therefore, let us work by totals from the given profit item of $90,000,—$50,000 New York and $40,000 Chicago,—to see what result may be secured. After so doing, we can complete the Profit and Loss account.

Balance, representing Operating Profits, Unadjusted		$ 90,000.00
Operation Expenses (not included above):		
Repairs and Renewals	$ 35,000.00	
Depreciation (5% on $400,000)	20,000.00	55,000.00
Balance, representing Net Operating Profit, Adjusted		$ 35,000.00
Financial Expenses:		
Interest on Loans	$ 6.800.00	
Interest on Capital (5% on $300,000)	15,000.00	21,800 00
Balance, representing Net Profit, available for distribution		$ 13,200.00

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Profit and Loss Account
Year Ended December 31, 19—
Debits

Operation Expenses:	*Total*	*New York*	*Chicago*
Repairs and Renewals	$ 35,000.00	$ 20,000.00	$ 15,000.00
Depreciation of Plant:			
5% on $225,000.00	11,250.00	11,250.00	
5% on $175,000.00	8,750.00		8,750.00
$400,000.00			

	Total	New York	Chicago
Balance, Representing Net Operating Profits, Adjusted	$ 35,000.00	$ 18,750.00	$ 16,250.00
	$ 90,000.00	$ 50,000.00	$ 40,000.00
Financial Expenses:			
Interest on Loans, etc.:			
60% of $6,800.00	$ 4,080.00	$ 4,080.00	
40% of $6,800.00	2,720.00		$ 2,720.00
100%			
Interest on Capital:			
5% on $180,000.00	9,000.00	9,000.00	
5% on $120,000.00	6,000.00		6,000.00
Balance, Representing Net Profit Available for Distribution	13,200.00	5,670.00	7,530.00
	$ 35,000.00	$ 18,750.00	$ 16,250.00
Division of Profits:			
New York Partner:			
Salary for Year	$ 5,000.00	$ 5,000.00	
New York Capital	670.00	670.00	
Chicago Partner:			
Salary for Year	2,000.00		$ 2,000.00
Profits ¼ Remainder	1,382.50		1,382.50
Chicago Capital	4,147.50		4,147.50
	$ 13,200.00	$ 5,670.00	$ 7,530.00

Credits

	Total	*New York*	*Chicago*
Balance, Representing Operating Profits, Unadjusted	$ 90,000.00	$ 50,000.00	$ 40,000.00
Balance, Representing Net Operating Profits, Adjusted, brought down	35,000.00	18,750.00	16,250.00
Balance, Representing Net Profit Available for Distribution, brought down	13,200.00	5,670.00	7,530.00

CHAPTER XIII

SHIPMENTS AND CONSIGNMENTS

§ 234. Consignment Defined

When a merchant turns over or ships to another goods to be sold by the latter for the account of the shipper, the transaction is called a "consignment." The owner, the one who turns over the goods, is known as the consignor, and the receiver, the one to whom the goods are turned over for sales purposes, is designated as the consignee (usually a commission merchant or factor). The term "commission merchant," however, more strictly refers to the produce or grocery business. From the above it is seen that the handling of consignments must be considered from a double viewpoint:

1. That of the shipper
2. That of the receiver

Sometimes the word "shipment" is used to designate the goods sent to the consignee by the consignor and sometimes the term "consignment-out" is used. The latter term is preferable. The word "shipment" as used in this course, will be considered in a later chapter under the subject of Joint Ventures. The word "consignment" by itself generally is used to designate the goods received by the consignee; sometimes the term "consignment-in" is used. The latter term is preferable.

§ 235. Reasons for Shipping on Consignment

The reasons for shipping goods on consignment are

many. Certain of these are indicated below. Sometimes goods cannot readily be sold by direct sale on account of certain risks the purchaser must assume when he buys outright. When such is the case, as where there is a risk of spoiling if the goods are perishable, or a risk of insufficient sales demand, the owner may find it necessary to carry the risk up to the point of the actual selling of the goods. Again, a merchant who disposes of his goods through the agency of a factor is relieved of the burden of developing a market for the goods and of training a sales force. Again, a merchant may have a surplus of goods on hand which he cannot dispose of by direct method through his regular trade channels, and to help their sale along he will send them to some one for sale on commission. Also, the shipper may not consider the credit rating of a prospective customer sufficiently sound to warrant selling him on credit, in which event he may ship on consignment in order to retain title to the goods shipped. Again, it may be that custom and usage dictate that the shipper shall ship his goods on consignment instead upon a plan of direct sale.

From the standpoint of the retailer, two reasons should be mentioned for receiving goods on consignment. A retailer must be conservative in his buying so as not to find himself overstocked. And yet if he is too conservative in his buying, he may have a demand for certain goods but no goods with which to meet the demand; the result would be a considerable loss to him. The two horns of the dilemma may be avoided by having goods sent him on consignment. If the possible demand does not materialize, the retailer (the consignee) will be protected. Again, a retailer may not have the necessary capital with which to purchase goods outright; in such event, if he can secure goods on consignment, he may be able to have a complete stock on hand, whereas,

if he could not do so, he would be trading under a marked disadvantage.

§ 236. The Law Underlying Consignments

The general law of agency and bailments applies to the subject of consignments in a restricted sense. Agency is a division of the law of contracts defining the legal relation existing between a principal and the person who is appointed to represent and act for him (the agent). A bailment refers to the delivery of goods by one person to another for the purpose of the latter carrying out some special object in reference to such goods, and later, upon the completion of such object, to return the goods, if they have not been disposed of in the meantime according to directions given. A bailment may be for the benefit of:

1. The bailor, the one who owns the goods, or
2. The bailee, the one who receives them for a special purpose, or
3. Both bailor and bailee

As concerns consignments, the consignor is the principal, and the consignee the agent. The duties falling upon the consignee in his handling of, and caring for, the goods sent him are governed by the law of bailments.

When a consignment is sent the consignee by the consignor, the title to the goods so sent remains in the consignor, and the consignee, for his activities in relation to the goods consigned to his care receives any compensation that has been agreed to by the parties. Such compensation may assume one of the following forms:

1. Goods consigned are billed on memorandum at a certain amount, and the consignee secures as his compensation all money he receives above such billed amount

2. Goods may be so consigned that the consignee will receive as his compensation a certain percentage of the sales price secured, regardless of whether or not such sales price is fixed

There are two kinds of agents, general and special. A general agent represents his principal in all his business; whereas, a special agent would represent his principal in the performance of certain acts only. The major question in any particular case is to find out the agent's authority and duties. This authority may be directly conferred by agreement; it may be implied from the fact that the principal holds the agent out to the world as having that authority; or it may be incidental to certain powers expressly conferred. An agent can bind his principal only when he acts within his authority.

§ 237. Sale Versus Consignment

Sometimes the selling price is fixed by the consignor, and if the consignee sells for a less figure there must be some special reason for so doing; if not, the consignee is liable to be held by the consignor for the agreed price. On the other hand, it may be impossible for the consignor to fix the selling price, as in the produce business; in such case, the selling price is dependent upon the daily market or upon prices guaranteed by the consignee.

From the above, it is seen that the price may be fixed or guaranteed, and that when such is the case, one may, without deliberating further, conclude that a consignment upon such conditions has become a sale. Such, however, is not the case. The difference between a sale and a consignment is fundamentally a legal difference coupled with one based upon custom and practice. In general, when a sale takes place, title (ownership)

passes with the shipment of the goods in question; whereas, when goods are consigned, the title thereto still remains with the shipper until his agent, the consignee, has sold them. The consignee cannot dispose of goods consigned to him in any way other than that in which he has been instructed by the shipper; if they were his own goods he could do so. The consignee cannot make consigned goods security for his personal debts; this he could do if a sale had taken place. And in general, the consignee is not obliged to pay for the goods until after he has sold them; if they had been purchased by him, he would have to pay for them whether sold or not.

§ 238. Underlying Principles of Consignment Trading

From the above, certain deductions may be drawn concerning consignment trading:

1. The owner of the consigned goods retains title therein
2. The consigned goods are entrusted to the care of an agent or a factor for purposes of sale
3. The consignee, for services rendered, receives compensation based upon agreement favorable to both parties, usually a percentage of sales price as commission
4. The goods sold eventually must be settled for by the consignee to the consignor by a cash payment
5. The goods remaining unsold represent an accountability of the consignee to the consignor

The item of commission is usually the most important deduction made by the consignee from the amount to be remitted by him to the consignor. Other common deductions are freight, drayage, storage, insurance, and cash discounts, all a matter of agreement between the parties before shipment is made, or a matter governed

by the custom of the trade. If the consignee's customers are allowed a cash discount of a certain amount, as 2 per cent., 10 days, the consignee may, with the consent of the consignor, deduct 2 per cent. from the gross sales so as to protect himself against this possible loss.

§ 239. Broker Versus Factor

A broker is a middleman who brings people together for purposes of trade, or is a person who trades for others without having the property involved, ordinarily, in his possession. A broker is an agent, designated to sell property or goods but he does not actually hold possession of them. For services rendered, a broker receives a fee, usually designated by the word "brokerage."

A factor is a commission merchant. He is an agent to whom goods are sent to be sold. He has the goods of his principal in his possession and he sells them either in the name of such principal or in his own name. A broker differs from a factor, therefore, in that he sells in the name of, and for, his principal goods which he does not have but which will be delivered by the principal direct to the purchaser. Also, whereas a commission merchant collects the account after sale, and may sell on credit and take a negotiable instrument in payment of goods sold, a broker usually cannot do these things because he has no apparent authority for so doing. Again, at times, a commission merchant may warrant goods; a broker may not do so.

§ 240. The Factory or Mill Agent

A mill agent is an independent contractor who agrees to sell the entire output of a mill or factory. The mill sells the goods to the agent, and gives him actual possession of them. Therefore, since he has title and posses-

sion, he cannot rightfully be called an agent; he is a principal.

§ 241. Duties and Liabilities of Factor

The factor, unless instructed to the contrary, would exercise toward the goods consigned to his custody the same care he exercises toward his own. If he sells on credit, which may be done, he must be no less vigilant as to the credit standing of such customer than if he were selling his own goods on credit. He should be diligent in collecting the amounts due him from charge customers. He may warrant the goods if such practice is customary. He can give title to goods sold, and such title may be better than the one had by the principal, because a bona fide purchaser buying in ignorance as to who is the principal and as to what title the latter holds with reference to the goods will be protected even though the factor exceeds his authority in the sale of such goods. A factor need not insure goods in his possession against loss by fire or by theft.

As long as any part of the consigned goods remain in the factor's possession unsold, just so long will he be required to guard and protect them with reasonable diligence. What reasonable diligence amounts to under a given set of circumstances varies, depending principally upon the nature of the goods. Reasonable diligence is assumed to be that ordinary diligence exercised by the average person under a given set of circumstances. If specific instructions have been received from the principal, the factor must follow them absolutely. If instructions are not specific as to selling price, a factor must secure the highest prices possible. The selling price of live stock and farm produce usually is not specified because it is necessary to dispose of them as soon as they reach the market; if the selling price were fixed,

and the disposal of the goods thereby rendered impossible, the shipper would have to pay the carrying charges and stand all the loss due to deterioration. A factor is not supposed to buy for his own account goods entrusted to him by another for sale.

The factor is supposed to keep the goods of his principal separate from his own; also, the cash, notes and accounts receivable taken in exchange for them. This means that it must be possible to identify the principal's items readily at any time. Physical separation really is not meant by the above statement, but such separation in the factor's accounts that the exact status of the factor toward his principal may easily be ascertained. If the factor should appropriate goods or money to his own use which belong to his principal, he is liable both criminally and civilly.

Often the factor is required to incur expenses in connection with the goods consigned to him, as freight, insurance, drayage, duty, handling charges, etc. Unless his instructions are to the contrary, the factor may charge all such expenses against his principal. As an agent, the factor is not entitled to secret profits; all moneys he receives in the transaction of his principal's business must be accounted for. Even if transactions are illegal, accounts must be kept.

A factor has a lien against the consigned goods for any payments made by him on their account, and at times such lien may be enforced to the extent that the factor can sell the goods in his possession in order to satisfy such lien. And if the amount so secured is not sufficient to cover the total payments as made, the principal is liable to the factor for the deficiency. This lien is applicable to the commission owed the factor by the principal. In modern usage, a lien may be defined as a "charge imposed on specific property, real or personal,

by which it is made security for the performance of an act.'' The goods against which the lien is to be imposed must be in the possession of the factor in order that the latter may exercise this lien right.

§ 242. Del Credere Agent

When a commission merchant sells on credit, the accounts receivable arising therefrom belong to the principal, and if there should be any bad debts among such accounts their amount would have to be borne by the principal. Sometimes, however, the commission merchant guarantees the collection of all such accounts. In such event, the latter is known as a ''del credere'' agent. For his guaranty, the factor receives an extra commission, which may be called a ''guaranty.'' This guaranty would not apply to cash sales. Contrary to the usual rule that guaranty contracts must be in writing, the agreement between a principal and his del credere agent does not have to be in writing.

§ 243. Consignment Invoice

When a consignor sends goods out on consignment, he merely transfers custody of some of his property to another, the consignee. The consignee is accountable to the consignor for the merchandise, and to this end, the consignor makes out what is known as a consignment invoice, upon which the necessary accounting records are based. This invoice is sent the consignee who holds it in suspense, so to speak, until the goods called for therein are received, and upon their receipt he checks off the items thereon indicated so that his accountability will be only for goods actually received.

The consignment invoice may take one of two forms depending upon whether or not the sales price of the goods has been agreed to by both parties:

1. When no sales price has been agreed upon, the goods usually will be invoiced according to quantity only, no values being shown
2. When the sales price has been agreed upon, the invoice will usually show the prices and the resulting total value; but even in this event the invoice may only show quantities. Such values in some cases become the basis of settlement in case sale is made.

§ 244. Account Sales

Periodically, which may be monthly, or at least when a factor has disposed entirely of a shipment of goods consigned to him, the factor is required to render an accounting to the consignor; this he does in the form of a statement covering the activities of his custodianship. Such a statement is known as an "account sales."

The account sales sets out the following major facts:

1. Gross sales
2. Deductions therefrom for:
    a) Charges and expenses to be borne by consignor
    b) Commission payable to consignee
3. Resulting balance, being the net proceeds which the consignor is entitled to receive

The amount or quantity of goods received will be shown somewhere on the statement. The unsold goods items usually are indicated thereon by memorandum at the foot of the statement. The amount of the net proceeds may be remitted in cash or may be credited to the consignor's account, this depending upon the agreement between the principal and his factor.

An account sales may be made up in the form of a ledger account or it may be compiled in the running form. A specimen account sales is shown below:

ACCOUNT SALES No. 322

OF MERCHANDISE RECEIVED..........November 13, 1919..........
FROM....................The R. F. Dairy Farm....................
TO BE SOLD ON COMMISSION

...10 Tubs of Oakleaf Butter 880......................50..			440	00
....			...	...
....			...	...
	Charges		440	00
We enclose check for...$304.50...	Freight	7.00		
To settle above sales	Drayage	5.00		
Mdse on hand......none.........	Commission 5%...	22.00		
....	Storage			
	Insurance			
Present Market Price	Advertising			
....	Cooperage			
....	Containers	1.50	35	50
A. F. JONES & CO., Syracuse, N.Y.	Net Proceeds....		304	50

§ 245. Recording Consignments in Books of Account

The methods in use for handling consignments are many and varied. In general, the method to use under any one set of circumstances is dependent upon the following points:

1. Nature of the business
2. Kind of accounting system in use
3. What information the management desires

Of the many methods in use, the fundamental distinction between them is whether the record is one purely of a memorandum character, or is one which is part of the regular books of account.

1. If of a purely memorandum character, consignments are handled merely as a transfer of goods in harmony with the law of bailments

2. If consignments are fully taken up into the regular books of account, their handling is such that each one is allotted a separate ledger account. In such case, the factor will probably use a consign-

ment ledger and control this ledger on the general ledger by means of a controlling account

In every case the records of the consignor and consignee should reflect accurately the terms of the agreement existing between them.

The whole subject of handling consignments is in more or less confusion; accountants, as a rule, are never in accord thereon. Therefore, no one can well say when one method shall be used and when some other method is more desirable. Each individual case should be taken on its own merits. Sometimes, the handling of consignments may be well done on a memo basis, and again, at times, it may be more desirable to pass them through the regular books of account. As a rule, the author is probably safe in saying that consignments, both in and out, are better handled on a memo basis than on any other one.

§ 246. Memorandum Record for Consignments-Out

When consignment shipments are numerous, and it is desired to handle them by memorandum, each shipment made would be given a number, and all necessary details would be entered in a Shipment Record, one page of which would be assigned to each consignee receiving more than one shipment; if a consignee is sent but one shipment, just part of one page in the Shipment Record would be allowed him.

When consignments-out are infrequent, a memorandum of each such shipment may be made upon the General Journal, without extending amounts out into the money columns.

When an account sales is received, the items thereon shown to be sold are checked against the Shipment Record, if the latter is kept, so that the unchecked items will

represent goods in the hands of the consignee. And when such account sales is received, under either development, an entry would be made upon the regular books of account, about as follows:

Dr. Consignee (or Cash)
  Cr. Consignment Sales
 To record net proceeds

§ 247. Recording Consignments-Out in Regular Books of Account

When a consignment shipment is taken up into the regular books of account at the time it is made, each such shipment would be given a separate Ledger account with a number; this account is placed either in the regular General Ledger (if such shipments are few), or in a special Consignment Ledger (if such shipments are numerous). Three methods of recording a consignment upon the consignor's books of account are shown below.

Method No. 1. This method is simple and may be used where but few consignments-out are shipped. When a shipment is made to a consignee, the following entry would appear in the Journal:

Consignments-Out (or Shipments)
 To—Purchases (or Inventory)

All expenses incurred are debited to the consignment account, and credited to Cash or to an account payable. When the net proceeds are received, the method of record will depend upon whether or not the expenses and commission deducted by the consignee are to be taken into the books. The usual procedure is not to do so, in which case only the cash will be debited to the Cash account and the Consignments-Out account will be credited. The entries follow:

1. When net proceeds only taken up:

Cash (through cash book)........	$ ¢	
To—Consignments-Out (or Shipments		$ ¢

2. When expenses and commission taken up:

Consignment-Out (or Shipment)..For expenses and commission per account sales	$ ¢	
Cash (or an account receivable) account with factor........	$ ¢	
To—Consignments-Out (or Shipments) .... For gross sales reported		$ ¢

As each consignment is closed, or periodically, as when statements are made out, the cost of the consignments closed out will be balanced against the sales, and the difference transferred to a special consignments-out Profit account. When the books are closed, the balance of this Profit account is closed out to Profit and Loss. The balance in this Profit account represents the profit or loss on consignments-out closed out during the period. The amount of this profit or loss is carried into the Statement of Profit and Loss either as an addition to, or as a deduction from, gross profit on sales.

The above method may be criticized in that it is not advisable to make a credit, in the first instance, to the Purchases or Inventory account. To do so, unduly complicates these accounts; they should show in the simplest way possible the cost of goods bought during a fisca period and what was on hand at the beginning of the period.

Method No. 2. After each shipment, an entry would be made upon the General Journal, or, where consignments are numerous, upon a special Journal, or in a

special column upon the regular Sales Journal; the entry follows:

Consignments-Out (or Shipments)	$ ¢	
To—Consignment Sales		$ ¢
To record invoice value of goods sent		

Expenses incurred are charged to the regular expense accounts instead of to the consignment account. When the account sales is received, the regular Sales account is credited either with the net or gross proceeds, and the accounts with Cash, Expenses, and Consignee are debited, as was explained in the first method. Then an entry would be made reversing the first entry given above, as concerns this particular consignment:

Consignment Sales	$ ¢	
To—Consignments-Out (or Shipments)		$ ¢

This second method is poor in that it does not distinguish between the net result from consignment sales and from regular sales, the two classes of sales being merged into one record.

Method No. 3. After each shipment, entry would be made as follows:

A—Consignment (or Shipment) No 1	$ ¢	
To—Consignment Sales		$ ¢

Charges against the consignment, as freight, cartage, etc., would be charged to the consignment account with A, and would be considered temporarily as asset values in conjunction with the asset value of the consignment itself until such time as the transaction was actually realized upon. At such time, the consignment transaction changes its character to that of an actual account

receivable, which may temporarily remain as such, or be changed again,—now to cash.

A—Consignee (or Cash if received)...$ ¢
To—A—Consignment (or Shipment)
No. 1 .... $ ¢

If at such time, the consignment has been entirely sold out, the balance in the account of A-Consignment No. 1 represents the profit (if a credit) or the loss (if a debit) on the transaction. Eventually, this balance is passed into the Profit and Loss account.

In methods Nos. 2 and 3, a special Sales account is credited rather than the regular Sales Account, because consignments sales are not actual, only prospective; the owner still retains his title to the consigned goods. Other methods of handling consignments might be given, but the above are deemed sufficient to illustrate the principles underlying the subject of consignments-out.

§ 248. Treatment of Consignments-Out in Balance Sheet

If the consignor closes his books before he has received all the account sales representing complete sales of goods out on consignment, care should be taken to take up properly in the Balance Sheet the inventory values of goods still unsold standing out on consignment. Expenses incurred in sending goods out may be considered as part of their cost, but care should be observed by the consignor not to inflate the values of his merchandise by shipping them from place to place. If goods are shipped from place to place, the transportation costs are an actual expense to be charged off at the end of the year. The valuation of goods out on consignment will depend upon their present market value, upon fluctuations due to style or fashion, and upon deterioration due to their being shop worn.

If consignments are not taken up into the accounts until the time of sale, no discussion is necessary under this heading. If goods still remain out on consignment at the date of the Balance Sheet, the facts may be handled in any one of the following ways depending upon the desires of the statement constructor, coupled with the idea of making such statement intelligible to the reader:

1. Show them merely as part of the inventory without distinguishing between goods on consignment and goods in the establishment. Then refer in a footnote to the Balance Sheet to the fact that a certain amount of said inventory, naming the amount, is in the hands of consignees. Freight and other transportation charges would be included
2. Show them as part of the inventory under a separate caption. Freight and other transportation costs would be included
3. Show total merchandise inventory including the merchandise cost of consignments-out in this total. Then directly below, indented, show the total cost of the goods out on consignment, including freight and transportation costs. From this total deduct the merchandise cost of the goods consigned, and extend as an additional asset the excess representing the transportation and freight costs.

§ 249. Recording Consignments-In in Books of Account

The bookkeeping for the consignee is simpler than that of the consignor. Consignments-in may be handled in either one of two ways:

1. Upon a memorandum basis
2. Upon the basis of making no entries until the goods have actually been sold or expenses incurred, at which time accounts are opened to show the money obligations to or by the consignor

As was said above, concerning consignments-out, it is probable in most cases that it will be found more con-

venient to carry consignment transactions on memorandum than to include them in the general books. The same is true of consignments-in.

In introducing the student to the subject of consignments, we first considered the entries made from the standpoint of the consignor, and various possibilities concerning these were pointed out in order to familiarize him with the various methods with which he may come into contact in practice. At the present point in our study, it seems best to eliminate a detailed discussion of all possible ways of handling consignments-in, and to confine ourselves to a consideration of handling such transactions on a memorandum basis. With a knowledge of this method and with a knowledge of the various possibilities presented under the discussion of consignments-out, it ought not to be difficult to recognize all the possibilities of handling consignments-in, or at least, most of them.

In fact, if a student should be called upon to recommend a method of handling consignments, whether from the point of view of consignor or consignee, he will not, in general, go amiss if he confines himself to suggesting that they be handled on memo. Other factors being equal, the making of complete entries in regular books of account involves additional work and serves no purpose not equally well served by memo entries. Of course, circumstances alter cases, as where there is a financial obligation on the part of the consignee making his relationship toward the consignor other than that of a mere bailee.

§ 250. Memorandum Record for Consignments-In

Consignments-in would be recorded upon a memorandum basis until the occurrence of a financial transaction in connection therewith. This memo record is made to

secure proper control of consigned goods on hand. As soon as an amount, however small, is paid out for freight or for some other expense, there exists a transaction which requires recording.

The memo entry for a consignment-in should be complete in detail as to goods received and terms under which they are to be sold. When an expense is incurred in connection with a consignment a ledger account would be opened with the consignment to record such expense. One such account should be kept with each consignment even though more than one is received from the same person.

If consignments-in are numerous, a separate memo book may be used in which to keep track of them. Such a record would contain dates, consignors' names, quantities received, and other information concerning freight, etc., on consignments. A consignment sales book would be kept, also, in which are recorded consignors' names for whom sales are made, amounts, etc., and from this record credits would be made to the accounts carried.

As expenses are incurred, usually for cash, an entry would be made therefor upon the regular Cash Book. Such expenses are termed "advances." In certain lines of business, advances are made also against consignments when the salability of the goods held on consignment is certain. However, such advances, ordinarily, would never be more than the possible net proceeds. Therefore, it is seen that advances cover both expense items and loans against future sales. Since advances represent cash credits upon the Cash Book, the offsetting debit against such credits would be made to the various consignment accounts. When sales are made, either cash or an account receivable comes in, and the offsetting credits would be against the consignment accounts.

The entries thus far indicated may be summarized about as follows:

1. Memo record of consignments received
2. Advances for expenses:
   Dr. Consignment No. —, A. Jones $ ¢
   Cr. Cash (or an account payable) .... $ ¢
3. Advances against future sales:
   Dr. Consignment No. —, A. Jones $ ¢
   Cr. Cash .... $ ¢

In addition to the above entries, other entries must be made from time to time, for which purpose the Journal would be used; such an entry, for example, would be made for commission due consignee for his services in behalf of consignment activities:

Dr. Consignment No. —, A. Jones...... $ ¢
Cr. Commissions Earned .... $ ¢

When all entries covering a consignment have been made, the consignment account balance should indicate the net liability of the consignee to the consignor. Since advances, as a rule, are never more than the possible net proceeds, as indicated above, the consignment account usually will show a credit balance indicating the net liability to the consignor. Where many consignments are received from one person, each such liability balance may be transferred to one general account with the consignor. From such account, the account current would be prepared. (For discussion of an account current, see Course No. 1.)

§ 251. Treatment of Consignments-In in Balance Sheet

When the consignee closes his books, he should take an inventory of goods held on consignment and check such inventory against his memo record of consignments

received. This is necessary, also, for making out correctly his account sales covering partly sold consignments, which would be rendered therefor at this time.

When the business statements are prepared, unsold consignments are not considered except to the extent of advances. Advances should be secured by goods on hand. Advances made to the consignor are assets and should appear as such in the Balance Sheet. Therefore, consignment accounts with debit balances are really special accounts receivable, secured by merchandise. As such, they should be shown in the Balance Sheet as a separate division of the accounts receivable. Consignment accounts with credit balances indicate a liability of the consignee, and after proper adjustments have been made covering commissions actually earned to date, etc., such liability accounts would appear upon the Balance Sheet as one figure, as a separate division of the accounts payable. Inventories of consigned goods on hand are not shown upon the Balance Sheet, because they do not belong to the consignee. At times, their amount is shown as a footnote, so that no misunderstanding will arise as to their inclusion in the regular merchandise inventory.

§ 252. Del Credere Agency and Books of Account

The shipper, when sales are guaranteed, should credit the account of the consignee with the amount due to him for the guaranty, and should debit an appropriate expense account for the corresponding amount.

The consignee, under a del credere agency agreement, may consider the charges made to his customers at time of sale to be valid assets. If this be done, he should consider the balance in the consignment sales account as a liability. The extra compensation charged for guaranteeing the account should be debited against the ac-

count of the shipper, and be credited to a guaranty account.

§ 253. Illustrative Problem on Consignments

The following problem and its solution is presented to illustrate the principles underlying consignment accounts.

Problem. A ships to B on consignment, under date of April 4, merchandise to the value of $1,500, paying $15 cartage and $6 insurance. B receives the consignment on April 20, paying freight $70, and cartage $12. He subsequently disposes of the merchandise by sale as follows: April 30, $400; May 30, $800; June 30, $600; on which latter he pays storage charges $30. He charges commissions on sales 5%, credits net interest at 6%, and transmits account sales with remittance of net proceeds to A, who receives them July 10.

Prepare shipment account as appearing on A's ledger and consignment account as appearing on B's ledger, supporting same by journal entries.

Solution: Entries on Books of A. The entries upon the books of A are as follows, the Journal entries being given first, and the Ledger accounts prepared therefrom being shown subsequently.

April 4

1. B, Consignment Account		$ 1,500.00	
To—Goods on Consignment			$ 1,500.00
To record consignment sent B.			
2. B, Consignment Account		21.00	
To—Cash (see Cash Book)			21.00
To record: Cartage paid	$ 15.00		
Insurance paid	6.00		
Total	$ 21.00		

July 10

3. B, Consignee Account	1,800.00	
To—B. Consignment Account		1,800.00
To record gross proceeds.		

4. B, Consignment Account	$ 202.00	
To—B, Consignee Account		$ 202.00
To record expenses incurred by signee for consignor, and to take up commission charged by consignor:		
Freight ..... $ 70.00		
Cartage 12.00		
Storage 30.00		
Commission 90.00		
Total $202.00		
5. B, Consignment Account	77.00	
To—Profit and Loss		77.00
To record profit shown by balance in consignment account.		
6. Interest Expense	1.16	
To—M, Consignee Account		1.16
To record interest on advances made by B, between April 20 and July 10:		
Freight ..... $ 70.00		
Cartage 12.00		
Total ..... $ 82.00		
Storage 30.00		
Total $112.00		
$82 @ 6%, 81 da. ..... $ 1.11		
$30 @ 6%, 10 da. ..... .05		
Total ..... $ 1.16		
7. B, Consignee Account	11.10	
To—Interest Income		11.10
To record interest on sales by B:		
April 30, $400 @ 6%, 71 da. . $ 4.72		
May 30, $800 @ 6%, 40 da. . . 5.36		
June 30, $600 @ 6%, 10 da. . . 1.02		
Total ..... $ 11.10		
8. Profit and Loss	1.16	
To—Interest Expense		1.16
To close.		
9. Interest Income	11.10	
To—Profit and Loss		11.10
To close.		
10. Cash (Cash Book)	1,607.94	
To—B, Consignee		1,607.94
To record net proceeds received in cash.		

When interest is involved, it is desirable to show the profit from this item separate from that on merchandise. Therefore, the separate Interest accounts are set up.

11. Goods on Consignment	$ 1,500.00	
To—Merchandise (Purchses or Inventory).		$ 1,500.00
To close.		

Ledger of A

B, Consignment Account

19—			19—		
Apr. 4	Mdse on Consignment .....(1)	$1,500.00	July 10	B, Consignee (3)	$1,800.00
	Cartage ...15				
	Insurance . 6 (2)	21.00			
July 10	Freight ...70				
	Cartage ...12				
	Storage ...30				
	Com 90 (4)	202.00			
	Profit & Loss. (5)	77.00			
		$1,800.00			$1,800.00

Goods on Consignment

19—			19—		
July 10	Merchandise (11)	$1,500.00	Apr. 4	B, Consgmt. A/c ......(1)	$1,500.00

Cash Account

19—			19—		
July 10	B, Consignee (10)	$1,607.94	Apr. 4	B, Consgmt. A/c ....(2)	$ 21.00

B, Consignee Account

19—			19—		
July 10	B, Consgmt. A/c ....(3)	$1,800.00	July 10	B, Consgmt A/c ....(4)	$ 202.00
	Interest Income ......(7)	11.10		Interest Expense .....(6)	1.16
				Cash ....(10)	1,607.94
		$1,811.10			$1,811.10

Profit and Loss

19—			19—		
			July 10	B, Consgmt. A/c ....(5)	$ 77.00
July 10	Interest Expense ......(8)	$1.16		Interest Income .....(9)	11.10

Interest Expense

19—			19—		
July 10	B, Consignee (6)	$ 1.16	July 10	Profit and Loss ...... (8)	$ 1.16

Interest Income

19—			19—		
July 10	Profit and Loss ...... (9)	$11.10	July 10	B, Consignee. (7)	$11.10

Merchandise

			19—		
			July 10	Goods on Consgmt. .... (11)	$1,500.00

ENTRIES ON BOOKS OF B

Journal Entries

April 20

1. Consignment from A	$1,500.00	
To—A, Consignor		$1,500.00
To record value of goods received.		
2. A, Consignor	82.00	
To—Cash		82.00
To record: Freight .... $ 70.00		
Cartage 12.00		
Total .... $ 82.00		

April 30

3. Accounts Receivable (or Cash)	400.00	
To—Consignment from A		400.00
To record sales made.		

May 30

4. Accounts Receivable (or Cash)	800.00	
To—Consignment from A		800.00
To record sales made.		

June 30

5. Accounts Receivable (or Cash)	600.00	
To—Consignment from A		600.00
To record sales made.		
6. A, Consignor	30.00	
To—Cash		30.00
To record storage charges paid.		
7. A, Consignor	90.00	
To—Commission Earned		90.00
To record 5% commission on gross sales.		
8. Consignment from A	300.00	
To—A, Consignor		300.00
To record profit on sales.		

July 10

9. A, Consignor	1.16	
To—Interest Income		1.16
To record interest on advances by B:		
Freight $ 70.00		
Cartage 12.00		
Total $ 82.00		
Storage $ 30.00		
\$82 @ 6%, 81 da $ 1.11		
\$30 @ 6%, 10 da .05		
Total $ 1.16		
10. Interest Expense	11.10	
To—A, Consignor		11.10
To record interest on money from sales, retained by B:		
April 30, \$400 @ 6%, 71 da $ 4.72		
May 30, \$800 @ 6%, 40 da 5.36		
June 30, \$600 @ 6%, 10 da 1.02		
Total $ 11.10		
11. A, Consignor	1,607.94	
To—Cash (or an Account Payable)		1,607.94
To record net proceeds owed A by B, which may be paid in cash.		

Ledger of B

Consignment from A

19—			19—		
April 20	A, Consignor (1)	$1,500.00	April 30	Cash (3)	$ 400.00
June 30	A, Consignor (8)	300.00	May 30	Cash (4)	800.00
			June 30	Cash (5)	600.00
		$1,800.00			$1,800.00

A, Consignor

19—			19—		
April 20	Freight, cartage (2)	$ 82.00	April 20	Consgmt from A (1)	$1,500.00
June 30	Cash (6)	30.00	June 30	Consgmt from A (8)	300.00
	Cash (7)	90.00	July 10	Interest Exp. (10)	11.10
July 10	Interest Income (9)	1.16			
	Cash (11)	1,607.94			
		$1,811.10			$1,811.10

Cash

19—			19—		
April 30	Consgmt from A .... (3)	$ 400.00	April 20	A, Consignor .... (2)	$ 82.00
May 30	Consgmt from A .... (4)	800.00	June 30	A, Consignor .... (6)	30.00
June 30	Consgmt from A .... (5)	600.00	July 10	A, Consignor .... (11)	1,607.94

Commission Earned

			19—		
			June 30	A, Consignor .... (7)	90.00

Interest Income

			19—		
			July 10	A, Consignor .... (9)	$ 1.16

Interest Expense

			19—		
July 10	A, Consignor .... (10)	$ 11.10			

CHAPTER XIV

PART I. AVERAGE DUE DATE

§ 254. Introduction

Before taking up the subject of average due date which involves a discussion of two types of problems:

> 1. Averaging an account,—determining the balance as of a certain date, with interest charged and credited at a certain rate
> 2. Ascertaining the equated date,—the date on which the balance of an account is at a minimum so that then it may be settled with a payment of interest

it seems advisable to say a few specific words concerning the subject of interest. In the two types of average due date problems, as shown above, the handling of the interest element is all important; in fact, it is the most important principle involved.

§ 255. Table of Multiples

Often an accountant finds it necessary in computing interest, etc., to use the same number over and over again as either multiplicand or divisor. When this need arises, it will be advantageous, in order to save time, to prepare a table of multiples to which to refer. In income tax work, for example, it is often necessary to compute a certain amount based upon the exact number of days a certain sum has been in use. To simplify this work, we would prepare a table of 365, as a divisor, from 1 to 10, as follows:

1	365
2	730
3	1,095
4	1,460
5	1,825
6	2,190
7	2,555
8	2,920
9	3,285
10	3,650

§ 256. The Use of Decimal Places

The number of decimal places to use in order to secure accuracy in computation depends upon the case in hand. The farther out an answer is carried, the more accurate will that answer be. In ordinary arithmetical work, involving the use of dollars and cents, as in bond amortization and annuity schedules, all amounts should be carried out to at least four places; this means that all values will be carried out to hundredths of a cent.

§ 257. Interest

Interest may be defined as "the increase of indebtedness through the lapse of time." In interest computations, four factors must be taken into consideration:

1. Principal
2. Rate
3. Unit period
4. Time

The principal represents the number of units originally invested. The rate refers to the fractional part of a unit of value which is to be added to the principal by the efflux of a unit of time. The unit period represents the length of a unit of time, as years, months, and days. The time refers to the number of these time units during which the indebtedness runs.

In computations, by means of formulæ, some of these above usually are represented by letters. We might, for example, say that P represents the principal, r the rate, and t the time. Therefore, P plus r, as applied to the basis of $1 for one year, would represent the amount of $1 at the end of the first year of calculation. If the rate is 5%, we would have $1.05 at the end of the first year; or in general, at the end of each period a debt increases 1.05 times what it was at the beginning. More will be said concerning this point in a later course in which are discussed annuities and sinking funds.

§ 258. Methods of Computing Simple Interest

Simple interest may be calculated in any one of three basic ways, each one differing from the others by the way in which time is determined.

1. Common time. The year is divided into 12 months of 30 days each, making in all 360 days. It is a common division of time used by business men when figuring interest but, of course, is entirely unsatisfactory if one desires anything in the way of a result approaching accuracy.
2. Exact time. The year is divided into 365 days, no division into months being made. From an accountant's point of view, this method is more satisfactory than the first one above mentioned.
3. Bankers' time. Under this method, the exact number of days is determined and this result is divided by 60; in other words, it is a combination of the first two methods. A note due two months from July 3, is due September 3, whereas, if it is due 60 days from July 3, it is due September 1.

§ 259. The Sixty-Day Method

This method is a common one in use for figuring interest by bankers' time at 6%. One dollar in one year at 6% earns 6 cents. Therefore, it will take 1/6 of a

year, which by this method is 60 days, to earn one cent, or 1% of itself. If we take any principal we find, in general, that at 6% in 60 days it will earn 1% of itself; and that in 6 days it will earn 1/10 of 1% of itself.

To determine the interest at 6% for 60 days for any principal, it is only necessary, therefore, to point off two places in the principal sum, and to point off three places when the interest is for 6 days. With this as a basis, it is an easy matter to determine the interest at any rate on a principal sum for any number of days. Assume, we wish to find the interest at 5% on $310 for 131 days;

At 6% for 60 days, the interest is..................	$3.1000
At 6% for 60 days more, the interest is.............	3.1000
120 days is twice 60 days	
At 6% for 10 days, the interest is 1/6 of $3.1000.......	.5166
At 6% for 1 day, the interest is 1/10 of $.5166.........	.0516
Total	$6.7682
Now, at 5%, subtract 1/6 of this......................	1.1280
Balance, the interest amount desired.................	$5.6402

Any period of time can be divided into multiples and fractions of 60 days, to expedite computation.

Another method of calculating simple interest which is a variation of the one shown above, and which is advocated by many, may be described about as follows:

The interest on $1,000 for 1 year at 36% is $360. The interest on the same sum at the same rate, for one month, is $30. Assume there are 30 days in the month; then the interest on $1,000 for one day at 36% is $1. $1 is 1/1000 of $1,000; therefore, we can say that the interest on a sum for one day at 36% equals 1/1000 of the sum. The interest for one day at 36%, therefore, can be found by removing the decimal point three places to the left. $1,000 will be reduced to $1.

Now to determine the interest at any percentage, from the above basis. When the decimal point is re-

moved three places to the left we have the interest for one day at 36%. If this result is divided by 36, we get the interest at 1% for one day. If now we desire to get the interest at 4%, the result obtained just above will be multiplied by 4; at 6% by 6, and so on. Thus far the computation has been for only one day; we must now multiply the result by the number of days. Assume the time is 25 days. At 4%, the following results:

$$\frac{1{,}000 \times 4 \times 25}{36} = \text{Interest}$$

At 6%, we get the following:

$$\frac{1{,}000 \times 6 \times 25}{36} = \text{Interest}$$

At 7%, the following results:

$$\frac{1{,}000 \times 7 \times 25}{36} = \text{Interest}$$

From these illustrations we deduce the following rule:

1. Determine 1/1000 of the principal, by removing decimal point three places to the left
2. Divide by 36 to secure the interest at 1%
3. Next multiply by the number of days given as the time
4. Next multiply by the desired rate
5. Set problem up in the form of an equation or fraction to simplify the calculation, the simplification being made by means of cancellation

§ 260. Averaging an Account

Averaging an account may be illustrated by the following simple problem and its solution.

Problem. Find the balance of the following account on July 1, interest at 5%:

Charges:	April 28, 30-day note, without interest	$1,000
	May 18, 60-day note, without interest	1,200
	June 22, Cash	1,000
Credits:	June 4, Cash	500
	June 18, Cash	100

Solution. Thirty days from April 28 is May 27; therefore, the 30-day note is dated from May 27. Sixty days from May 18 is July 17; therefore, the 60-day note is dated July 17. Since the balance is to be found as of July 1, when the 60-day note is considered, 16 days' discount must be calculated.

Amount	*Due Date*	*Time*	*Product*	*Amount*	*Due Date*	*Time*	*Product*
$1,000	May 27	35	35,000	$500	June 4	27	13,500
1,200	July 17	16	19,200 (—)	100	June 18	13	1,300
1,000	June 22	9	9,000				
				$600			14,800
$3,200			24,800				
600			14,800				
$2,600			10,000				

One day's interest @ 5% on $10,000 is...		$1.3889
Balance of principle due is	$2,600.00	
Balance of interest due is	1.3889	
Total	$2,601.3889	

§ 261. Equation of Accounts: Average Due Date of Current Accounts

The equation of accounts contemplates ascertaining the date when

1. Many items due at different dates may equitably be paid in one amount, or
2. The balance of an account may be settled equitably

without loss of interest to either party. From our previous study of accounts, it is known that accounts at times may be one-sided or two-sided,—be all debits or all credits; and at times they may be composed of both debit and credit items. Therefore, in studying equated

accounts it is necessary to consider both the classes or types referred to. The subject of equation of accounts is considered here because often it is necessary to determine the due date of the net proceeds of an account sales, as described in the last chapter.

The equated date of an account is "the date on which the balance of the account is at a minimum." The date upon which the balance of an account is at a minimum must, necessarily, be the date upon which the interest is at a minimum. As goods and wares are purchased, interest begins to accumulate upon the indebtedness; and as the goods are paid for the indebtedness gradually becomes reduced. Somewhere between the date of purchase and the date of payment, there is a date upon which the interest on the debt and the discount on the payments made equalize each other. When there is only one debit and one credit item in the account, the determination of this neutral date is not difficult, but when the account debits and credits are many, the determination of this neutral date is rather complicated. Some one date is selected as the balancing date. It is immaterial what date this selected date may be, but usually the earliest or the latest date given in the problem is taken. The reason for making such a selection is to have only one type of operation to perform. If the earliest date is selected, all items up to that date are discounted; if the latest date is selected, all items up to that date are accumulated. When the account has been balanced as of the selected date (the focal date), we compute how many days the focal date is in error, and count forward or backward, as the case may be.

§ 262. Average Due Date of a One-Sided Account

Problem. The following simple problem illustrates finding the average due date for an account with items only on one side; A purchased goods of B, as follows:

May 4 (30 days) $800
May 30 (2 months) 500
June 8 400
June 20 300

Find the average due date.

Solution 1. The solution to the above problem is set out by the following tabulation:

Date	*Term*	*Date Due*	*Amount Due*	*Days from June 3*	*Product*
May 4	30 days	June 3	$ 800.00	..	.....
May 30	2 mo.	July 30	500.00	57	28,500
June 8	....	June 8	400.00	5	2,000
June 20	....	June 20	300.00	17	5,100
			$2,000.00		35,600

35,600 divided by 2,000 equals 17 plus, or 18

Average due date is 18 days from June 3, or June 21.

Solution 2. The following method of solution differs somewhat from the first one shown above, in that it is a sort of a short-cut method. In certain cases, this second method may produce a result a day different from that produced by the more common methods. Yet, if this second method is compared with the others by actual use over a period of time, it will be found sufficiently accurate for practical purposes.

(1)	(2)	(3)	(4)	(5)		(6)	(7)		
			Date	*Due*					
Date	*Term*	*Amount Due*	*Month*	*Day*					
May 4	30 days	$ 800.00	6	3	—	4,800	2,400		
May 30	2 mo.	500.00	7	30	—	3,500	15,000		
June 8	....	400.00	6	8	—	2,400	3,200	(8)	(9)
June 20	....	300.00	6	20	—	1,800	6,000		
		$2,000.00				12,500	26,000	6	20.8
						12,000	15,000		
						500	41,600		
						30	40 00		
						15,000	1,600		
							0 000		
							1 6000		
							1 6000		

The average due date is June 21.

The first three columns are first completed. Then using its number to represent its month, columns 4 and 5 are filled in. Next, multiply each amount by the number of the corresponding month and then by the day of the month; the two operations being set down as in columns 6 and 7. Columns 3, 6 and 7 are then totaled. Column 6 total is then divided by the total of column 3. Place the resulting quotient at 8. The remainder (500) is then multiplied by 30 (30 days assumed to be one month) and the resulting product (15,000) is added to the footing of column 7. The resulting sum (41,600) is then divided by the total of column 3, and the quotient secured is placed at 9. The two quotients at 8 and 9, indicate the desired date,—the sixth month and the twenty-first day, or June 21. This date agrees exactly with that secured by solution No. 1.

If the second quotient at 9, is greater than the number of days in the month represented by the quotient at 8, subtract from the quotient at 9 the largest possible multiple of 30, and add to the quotient at 8 one for each time 30 is contained in that multiple. If the remainder resulting from the second division is more than half the footing of column 3, add one to the quotient at 9.

If all the dates come in the same month, columns 4 and 6 are omitted. If the dates are not all in the same year, January of the second year may be called the 13th month.

In using this method for finding the average date for the settlement of an account containing both debit and credit items (see next section following), the same general method of procedure is followed with each side of the account separately, down through the totaling of the columns. Then the total of each column on the smaller side of the account is subtracted from the total of the

corresponding column on the larger side, and the remainders then divided as already indicated.

From the first solution given above, the following rule may be deduced: Take any one of the various dates as a starting point (called the focal date), and multiply each amount by the number of days between this date and the date upon which the amount falls due. The sum of these products divided by the sum of the amounts gives the number of days between the selected date and the average due date. The average due date, the equated date, and the average date of payment are synonymous terms.

§ 263. Average Due Date of a Two-Sided Account

The following problem illustrates finding the average due date for an account with items on both sides. The method used is that of the first one discussed above.

Problem. The following sums are due by and to a merchant on the dates indicated. Upon what date should he settle his account, basing settlement on the average due date?

Debits		Credits	
Jan. 4	$3,000.00	Jan. 15	$. 500.00
Feb. 2	1,000.00	Feb. 1	1,500.00
Feb. 28	2,500.00		

Solution. The solution to this problem is set forth in the following tabulation:

Date Due	*Amount Due*	*Days from Jan. 4*	*Product*	*Date Due*	*Amount Due*	*Days from Jan. 4*	*Product*
Jan. 4	$3,000.00	0	......	Jan. 15	$ 500.00	11	5,500
Feb. 2	1,000.00	29	29,000	Feb. 1	1,500.00	28	42,000
Feb. 28	2,500.00	55	137,500		$2,000.00		47,500
	$6,500.00		166,500				
	2,000.00		47,500				
	$4,500.00		119,000				

119,000 divided by 4,500 equals 126 plus, or 27.
Therefore, average due date is January 31

§ 264. Counting Backward or Forward, from or to, Focal Date

When the balance of the account and the balance of interest are on the same side of the account, as on the debit side, or on the credit side, the person owing the balance of the account owes the balance of the interest in addition and, therefore, should have settled the account at an earlier date.

On the other hand, if the balance of the account and the balance of interest are on opposite sides of the account, the person who owes the balance of the account has the interest balance due to him and, therefore, may keep the balance of the account after the focal date long enough to earn the balance of interest.

§ 265. Application of Principle to Account Sales

In the last chapter the account sales was discussed. It was found to be made out in either the ledger or statement form. For the purpose of determining the average due date, it may be considered as a ledger account with both debit and credit items. The debits represent charges made by the factor against his consignor, and the credits represent the sales made by the consignee. In determining the average due date, the dates the sales are made should not be used; use the dates upon which payments therefore are due, their due dates. Charges paid by the consignee for expenses, as cartage, drayage, insurance, etc., are taken to be due upon the dates when paid by the consignee. In regard to the items of commission and guaranty, there exists a difference of opinion, and the matter should be settled by agreement. The various contentions relative to the due date of items of commission and guarantee are:

1. Average date of sales
2. Average due date of sales
3. Date of rendering account sales

When everything has been determined, the problem involved is finding the average due date of a two-sided account.

§ 266. Accounts Current

Accounts current have been defined previously as running accounts. The balance due on an account current is termed the cash balance. When two concerns deal with each other, and have mutual debits and credits, they will agree, or should, that the balance of the account is to be stated periodically,—monthly, quarterly, or annually. The problem involved is to find the balance due on such an account on a given date.

Interest accrues, and is collectible on overdue amounts. The debtor is entitled to discount on all items paid before maturity. The matter of interest is usually one of agreement, the rate per cent. running from the date of each item, or from the due date of each item, to the end of the stated period.

When the number of items in an account is few, the current account may be averaged according to the plan given above for finding the average due date of a two-sided account. The amount due on the date the cash balance is to be determined is ascertained by finding the interest on the balance of the account from the average due date to the date of settlement. If the average due date is later than the date of settlement, interest on the number of days difference should be subtracted from the balance of the account; if the date be earlier, the interest on the number of days difference should be added to the balance of the account. The above may be summarized as follows: If an account has been equated, the balance due on a given date is the balance of the account plus the interest or less the discount for the time between the equated date and the date of settlement according to

whether the date of settlement is after or before the focal date.

The usual method, the interest method, of ascertaining the cash balance of an account is shown below in connection with the following simple problem.

Problem. Money is worth 6%. Find the cash balance of the following account on January 1, 1920:

G. E. BAILEY

Debits			Credits		
1919			1919		
Sept. 8	Mdse	$1,200.00	Sept. 15	Cash	$ 500.00
Dec. 1	Mdse	1,500.00	Oct. 10	Cash	900.00
1920			Dec. 1	10 da. note	600.00
Jan. 10	Mdse	500.00			

Solution. The solution to the above problem is shown in the following tabulation:

Due Date	*Amt.*	*Days*	*Interest*	*Discount*	*Due Date*	*Amount*	*Days*	*Interest*
1919					1919			
Sept. 8	$1,200	115	$23.00	......	Sept. 15	$ 500	108	$ 9.00
Dec. 1	1,500	31	7.75	......	Oct. 10	900	83	12.45
1920					Dec. 11	600	21	2.10
Jan. 10	500	9 (—)	....	$ .75				
	$3,200		$30.75	$ .75		$2,000		$23.55

$3,200 plus $30.75 less $.75 is $3,230.00 is total debit
2,000 plus $23.55 is 2,023.55 is total credit

$1,206.45 is balance due

§ 267. Interest on Partial Payments

When the amounts involved are small or when the obligations themselves run only for a short period of time, the above discussion covering average due date and accounts current is sufficient. However, if the debt runs longer than a year, the interest on partial payments should be figured by what is known as the United States rule. The working of this rule is as follows: When a payment is made upon a debt drawing interest, such payment is first applied against the interest accrued to date of payment. If an excess of such payment remains,

this excess is applied against the existing principal to reduce its amount. Where the amount of any such payment is not sufficient to cancel the accrued interest to date, the uncancelled portion of interest remains to be cancelled by the next payment on account. The principal sum is not changed because the unpaid interest is not added to the principal against which future interest will accrue. To do so, means a compounding of interest, and a compounding of interest in most states is not allowed under the law.

As concerns partial payments, it may not be amiss to carry the discussion just a little further than its direct application to the matter in hand, as above indicated, because partial payments are made on notes, mortgages, and other interest-bearing documents; and when so made, due allowance therefor must be taken into consideration in computing the amount due at the time of settlement. These payments are all called indorsements. The methods in use are many for calculating the amount due at a given time upon these documents of indebtedness, against which partial payments have been made. Some of these methods have been adopted for the sake of convenience in computation, and others have been sanctioned by rulings of the Courts. The legislative enactments, in this particular, appear to have a two-fold aim:

1. To avoid usury
2. To avoid taking compound interest

The two most common rules for figuring partial payments are known as:

1. The United States rule
2. The mercantile rule

We are concerned at present only with the former. Unless the statutes prescribe to the contrary, the unit of

time, ordinarily, is a year of 365 days, although for the sake of convenience the year of 360 days is often used. Take the following simple problem with its solution as illustrating the procedure.

Problem. A commission merchant sold goods for a consignor on February 15, 1919, in the amount of $600. The remittances this merchant made from time to time were as follows: March 25, $150; June 1, $75; October 10, $100. How much did the consignee owe his consignor on December 31, 1919, interest being charged at the rate of 7%?

Solution. The following solution is in accord with the United States rule.

	Total	*Int.*	*Principal*
Principal sum, dating from Feb. 15, 1919	$600.00		$600.00
Interest to March 25, 38 days	4.37	$4.37	
Total	$604.37	$4.37	$600.00
Payment, March 25	150.00	4.37	145.63
Balance	$454.37		$454.37
Interest from March 25 to June 1, 68 days	5.92	$5.92	
Total	$460.29	$5.92	$454.37
Payment, June 1	75.00	5.92	69.08
Balance	$385.29		$385.29
Interest from June 1 to October 10, 131 days	9.68	$9.68	
Total	$394.97	$9.68	$385.29
Payment, October 10	100.00	9.68	90.32
Balance	$294.97		$294.97
Interest from October 10 to December 31, 82 days	4.64	$4.64	
Total	$299.61	$4.64	$294.97
Balance due December 31, 1919	$299.61		

Composed of:	
Principal	$294.97
Interest	4.64
As above	$299.61

The form in which this solution has been set up differs considerably from the usual forms found in books

on commercial arithmetic. However, it is offered here, because this was the only form acceptable to the Court upon two occasions when the writer was called upon to compute the amount due as on a date certain, said amount being in dispute and being concerned with partial payments upon a contract drawing interest and extending over a period of years.

Part 2. Joint Ventures

§ 268. Joint Venture Defined

A joint venture exists when two or more persons combine some capital, on a temporary partnership basis, to participate in some particular business deal involving the buying and selling of a single article, or trading in a particular lot of goods. A joint venture differs from the ordinary business in that it is a temporary association to carry through a special deal or transaction. The parties to a joint venture practically form a partnership for a definite purpose. The difference between their relations and those existing between ordinary partners is that the former arrangement is limited to a specific deal, whereas the latter is much more general and contemplates a much longer period of time.

It is more or less common in business that a joint venture be formed for the sale of a single article or of a lot of merchandise. But there are many special ventures in which two or more persons are interested in the profit outcome. Thus a person may consign goods, in which he deals, to a merchant in another city or town, two parties participating in such shipment. Again, the association may be formed to carry through a speculation in stocks or bonds, or to purchase a piece of land and build thereon, same to be sold at a later date. It is usual in joint ventures for one of the members to act

as manager and handle the transaction, he perhaps being allowed a small percentage to remunerate him for his time and trouble.

§ 269. Two Methods of Handling Joint Accounts

Joint ventures may be divided into two classes depending upon the method by which the accounts are kept:

> 1. A separate set of records is opened for the transactions and a separate joint bank account is used. These records are handled in the same manner as are those of an ordinary partnership. A Capital account is opened for each principal, the account being credited with his investment in the venture. Interest is calculated upon the capital, and profits and losses are shared according to the articles of agreement.
>
> 2. No separate set of records is opened. Each party, upon his own books, records the transactions he enters into in behalf of the venture. No joint bank account is used. Under this second method, each party must eventually render a detailed statement of all transactions entered into by him on account of the venture. The transactions from all the submitted statements would then be combined in what is known as the "Joint Venture" account, this account not appearing upon the books of any one party. The joint venture account is really a trading account indicating the profit or loss from the venture. Based upon the results therein shown, each party will debit or credit his account with the venture upon his own books for his share of the outcome. The balance of this account will indicate the amount due to him from the others or by him to the others.

§ 270. Illustrative Problem No. 1

Problem. A. Jones and B. Smith engage in a joint venture in coffee. They agree to purchase 100 bags,

Jones to purchase it, and Smith to sell it. All expenses incurred are chargeable to the cost of the venture. Profits are to be shared equally. A. Jones incurred the following costs:

100 bags of coffee @ $25	$2,500.00
Expressage	20.00
Storage	10.00
Total	$2,530.00

B. Smith incurred the following expenses, and received the following cash on account of the venture:

Expenses:	
Expressage	$ 25.00
Storage	20.00
Miscellaneous	50.00
Total	$ 95.00
Cash Received:	
75 bags @ $35	$2,625.00
25 bags @ $30	750.00
Total	$3,375.00

The above amounts were agreed to as correct by the two persons.

Solution. The solution to the above problem is shown in the following three accounts. The first account shows Jones' activity in connection with the venture; the second account shows the activity of Smith in connection therewith; and the third account combines the results of the first two.

A. Jones, Joint Venture in 100 Bags Coffee

19—			19—		
Due from B. Smith.....$2,905.00			Purchase, 100 bags.....		$2,500.00
			Expenses:		
			Expressage $20.00		
			Storage 10.00		
					30.00
			½ Net Profit...........		375.00
		$2,905.00			$2,905.00

B. Smith, Joint Venture in 100 Bags Coffee

19—		19—		
Cash from Sales:		Expenses:		
75 bags @ $35...$2,625		Expressage $25.00		
25 bags @ $30... 750		Storage 20.00		
	$3,375.00	Miscellaneous .. 50.00		
				$ 95.00
		½ Net Profit..........		375.00
		Due to A. Jones........		2,905.00
	$3,375.00			$3,375.00

A. JONES AND B. SMITH
Joint Venture Account
100 Bags Coffee

19—			19—	
Purchase, 100 bags.....		$2,500.00	Cash from Sales:	
Expenses, A. Jones:			75 bags @ $35.00.....	$2,625.00
Expressage $20.00			25 bags @ $30.00.....	750.00
Storage 10.00				
		30.00		
Expenses, B. Smith:				
Expressage $25.00				
Storage 20.00				
Miscellaneous .. 50.00				
		95.00		
Profit on Venture:				
A. Jones, ½...$375.00				
B. Smith, ½... 375.00				
		750.00		
		$3,375.00		$3,375.00

§ 271. Illustrative Problem No. 2

Problem. Plant and Company and Edwards and Company ship merchandise to South America on joint account. Edwards and Company gave Plant and Company $1,200 in cash and their acceptance at six months for $3,000. Plant and Company were to provide balance

of cash required, to manage the venture and to receive a commission of 2% on amount of invoice for merchandise. Profits to be divided equally.

Plant and Company paid Smith and Greer for merchandise $5,000, and discounted Edwards and Company's acceptance for $3,000, at 2% discount. Plant and Company prepaid freight $420, insurance $60. In due time Plant and Company received from South America an account sales for merchandise and a draft for net proceeds, payable in London for $3,200, out of which Plant and Company paid $3,000 to retire bills for that amount.

Later Plant and Company received a draft for $3,100, being balance of proceeds of sale of merchandise. The joint account with Edwards and Company was closed and a check for the balance due them was paid to Edwards and Company.

Prepare a statement showing details of the joint account, also a statement of Edwards and Company's account. (C.P.A.)

Solution. The solution to the above problem is as follows:

Plant and Company and Edwards and Company

Joint Account

as of................

Proceeds from Sales:		
Draft No. 1	$3,200.00	
Draft No. 2	3,100.00	
		$6,300.00
Less—Cost of Sales:		
Merchandise Purchases	$5,000.00	
Freight	420.00	
Insurance	60.00	
Commission (2% of purchases)	100.00	
		5,580.00
Balance, Net Profit on Venture		$ 720.00
Distribution of Net Profit:		
Plant and Company (½)	$ 360.00	
Edwards and Company (½)	360.00	
As above	$ 720.00	

EDWARDS AND COMPANY

Joint Venture Account

19—		19—	
Discount on Accept.	$ 60.00	Cash Receipts	$1,200.00
Acceptance paid	3,000.00	Acceptance Received	3,000.00
Cash, to Balance	1,500.00	½ Net Profit	360.00
	$4,560.00		$4,560.00

CHAPTER XV

MANUFACTURING ACCOUNTS

§ 272. Introduction

Modern cost accounting is the most difficult branch of accounting, being properly allocated under the general division of the subject known as system building. No attempt is made in the present chapter to do more than to consider some of the basic principles underlying the subject, those that a competent bookkeeper is ordinarily required to know concerning factory accounting. This contemplates the additional accounts a manufacturer would keep in his Ledger not ordinarily found in the Ledger of a trader, how these accounts operate so far as the General Ledger is concerned, what results these added accounts show, and why they are necessary.

A knowledge of the basic principles underlying the above-mentioned items should enable the student to prepare a satisfactory Statement of Profits and Income of a concern engaged in manufacturing, such statement to be prepared from a properly constructed Trial Balance or from memoranda bearing thereon intelligently written. Therefore, the title of this chapter is as shown. The subject of cost accounting will form the work of a separate and distinct course of lectures and problems.

§ 273. Trading Accounts Versus Manufacturing Accounts

What has been said thus far concerning trading accounts in general is applicable to manufacturing accounts. But in dealing with manufacturing accounts, there are more elements to consider. In a trading business, goods in finished condition are bought and sold.

The merchandise purchased is sold in the original condition in which it was secured. The only accounting necessary is to ascertain the cost of the goods sold; to arrive at the proceeds from such sales, the price realized; to find the relation between these two totals which results in gross profits. The various other expenses are charged against these gross profits, and the result is the securement of net profits. Where manufacturing accounts are concerned, the procedure is not simple.

A manufacturer's functions are to manufacture and sell. He buys raw materials, partly finished (semi-raw) materials, parts, packing supplies, etc., places them in his factory, supposedly well equipped, and with the services of both skilled and unskilled labor under proper supervision converts these materials into finished product; this finished product is marketable. The major difference between these two kinds of business lies in the way of acquiring the marketable goods.

A manufacturer may manufacture for either one of two reasons:

1. To secure a manufacturing profit,—finding it cheaper to manufacture and sell than to buy and sell, or
2. To secure a certain quality of goods not possible to get in the open market

Since his business is two-fold, a manufacturer should be able to determine whether it is more profitable to buy in the open market than to manufacture for himself.

The following plan will indicate the general organization of a manufacturing concern:

1. Production department (manufacture of goods)
2. Selling department (sale of finished goods)
3. Administrative department (general operation and supervision)

§ 274. Manufacturing Accounts Not Required in Trading

Mercantile expenses usually are of two classes,—selling and administrative. The expenses of a manufacturing concern include the above two classes and one more,—the third grouping, in general, being those concerned with production. In addition, provision must be made for the asset accounts peculiar to a manufacturing enterprise.

The Ledger accounts required in conformity with the above, would be, in general:

Machinery and equipment
Reserve for machinery and equipment
Patterns and drawings
Small tools
Patent rights
Raw materials
Payroll
  Productive labor
  Unproductive labor
Manufacturing parts
Factory supplies
Manufacturing expense
Goods in process
Finished goods
Sales of finished goods
Sales of by products

All these accounts are important, because without them an intelligent manufacturing statement at the end of any given period cannot be prepared.

§ 275. Elements of Manufacturing Cost

In finding out what it costs to manufacture the articles produced in a factory, all items or elements that in any way contribute to the expense or cost of bringing them into a condition in which they are readily salable must be taken into consideration. These items group themselves into three general classes:

1. Raw material
2. Labor
3. Factory expense

These three classes, usually, are divided again as follows:

1. Prime cost
    a) Material used (at total cost of same)
    b) Direct labor (labor of workmen actually engaged upon the product)
2. Factory burden or overhead. This includes such items as:
    a) Indirect labor of foremen, helpers, etc.
    b) General factory expenses, heat, light, power, etc.
    c) Factory supplies
    d) Depreciation of factory buildings and equipment
    e) Salaries of factory management

§ 276. Raw Material

Raw material is such material as must pass through certain manufacturing processes so that its original condition is altered before it is ready for sale as finished product. These processes may change entirely the nature of the material, or they may merely change its form. Sometimes purchases are made of materials which do not need alteration, but are attached in their original form to the manufactured product.

This second class of purchases is better considered as being finished parts rather than raw material. The cost of material is the total cost laid down in the factory. Because of this, such items as freight and cartage in, etc., thereon may be charged directly to the Materials account. Again, as part of the material cost, the cost of items directly essential in bringing the product into the condition in which it is to be sold should be taken up, as boxes, cases, cartons, etc.

§ 277. Finished Goods and Goods in Process

The term finished goods is synonymous with that of manufactured goods, and refers to those articles which a manufacturing concern produces for the purpose of selling. An article is not considered as finished until it is ready to be handed over to the selling department. The finished product of one factory may be the raw material of another.

Until an article is ready for the selling department, it is considered as being in process of manufacture. There may be at times some doubt as to when an article of a certain kind is considered finished or still in the process of manufacture, due to the fact that it may have to be put into a container. Flour and sugar must be put into barrels or bags, shredded wheat biscuit and breakfast foods into containers each holding a certain quantity of product. The barrel and the bag become part of the product, and the product is not a finished good until placed in such container. Similarly, the small box holding a dozen shredded wheat biscuits is part of the product, and the biscuits must be put into the boxes before being considered a finished product ready to be handed over to the selling department. On the other hand, however, where the container must be returned to the manufacturer, such container is not part of the cost prior to handing the product over to the selling department. This would be true of gasoline or beer which is a finished product when in the vats ready to be barreled.

When parts which are being manufactured, are completed, they are known as manufactured parts, not as finished goods.

§ 278. Manufactured Parts

Many times a finished article consists in whole or in part of different parts which have been manufactured

by the concern and which are later assembled into one main product, as in an automobile factory. Each such manufactured part, when completed, is not a finished good. The finished product is the automobile which is made by assembling together a great number of these various parts.

When some parts are purchased and some manufactured, the account keeping should distinguish between the two classes. Parts purchased may be considered as raw material being debited to the account of that name. The parts manufactured should be kept separate, and monthly the cost of all manufactured parts completed should be debited to an account of that name and be credited to the Manufacturing or In Process account.

§ 279. Labor

Labor is either productive or non-productive,—sometimes designated as direct and indirect. Productive labor is the part of a workman's time which can be allocated to a certain job or process, being directly employed on the raw material entering into a certain specific article or class of articles. Non-productive labor is that portion of a workman's time which cannot be so allocated to the cost of any specific article or process; it does not enter directly into the cost of the finished product; it consists of such items as wages of foremen, timekeepers, and watchmen, and the idle time of the productive workmen.

§ 280. Prime Cost

Prime cost consists of the cost of the raw material and the productive labor employed directly on such material. Some accountants will include in prime cost the manufacturing overhead, but when so done the resultant is better considered as being factory cost, not prime cost.

§ 281. Indirect Factory Expenses (Burden or Overhead)

Under this heading come all expenses of factory operation, except the materials entering into the finished product and the productive labor. Indirect expenses are not directly chargeable to any particular job or process, but must be prorated to the various jobs or units of product according to some approved method of distribution. Items of indirect factory expense would be in part: non-productive labor, heat, light, power, factory rent, superintendent's salary, taxes, insurance, and depreciation on factory buildings and equipment, repair and maintenance materials and expense, shop supplies such as oil, brooms, etc., etc. Prime cost plus indirect factory expenses results in gross manufacturing costs.

In determining the cost of manufactured goods sold or the cost value of goods on hand, selling expenses and general administrative expenses should be excluded. These add nothing to the value of the manufactured product. Factory cost ends with the completion of the product.

§ 282. Payroll

When a person works by the day, or by the hour, by the piece or quantity, the money received for such services is called wages. A wage earner is paid for the actual time put in or for the actual work accomplished. If a person is paid by the week, the month, or year, and he receives his pay whether actively employed or not, the money so received is called salary.

When one pays wages, as a manufacturer, he must have a record from which he can determine the time put in, or the quantity of work completed. This record takes the form either of a time book or of time cards. These forms vary in appearance, but all must provide for showing the workman's name, the hours and parts of hours

worked, on each kind of work or job,—or the number of units or quantities of work turned out, and the type of work done. This information is collected and recorded by the timekeeper, and sometimes by a foreman. On the basis of the information so recorded, the payroll is made up.

The payroll is merely a detailed summary of the information shown in the time book or on the time cards, plus what each individual has earned for the time put in or for the work completed. The payroll would be made up in loose-leaf or book form, and would show the following major information:

Workman's name
If day worker
  Hours worked
  Rate per hour
  Total wages earned
If piece worker
  Work completed
  Total wages earned

In addition, the payroll would be so columnarized as to indicate the departments or jobs against which the wages are to be charged; the unproductive labor would be separated from the productive so as to be shown by itself and this would then be distributed as desired among the columns provided.

The payroll may be entered upon the books in either one of two ways, as desired:

1. Charge in a lump sum to a Payroll account once a month. Then from a recap of the payroll credit the Payroll account and charge the various accounts over which the amount is to be spread, so that eventually the Payroll account as such contains nothing but undistributed items; as a rule, when credited, the Payroll account will be closed
2. Credit the amount of the payroll to Accounts

Payable at once and offset this credit by charges to the various accounts over which the amount is to be spread. This would usually be done on a voucher record. When the payroll check is drawn, it is entered on the Cash Book as a debit to Accounts Payable

Where a Voucher Record is used, distribution will be made, usually, as soon as entry is made upon such record. If no Voucher Record is used, as sometimes happens, the payroll may be distributed on the Cash Book when the check to cover is drawn. If the payroll has been charged to a Payroll account as in (1) above, the distribution would be made upon a Journal.

Since the end of a fiscal period and pay day seldom are the same, it happens, as a rule, that at the end of such period certain labor charges both direct and indirect have been incurred but have not been taken up on the books. Therefore, at the end of a fiscal period, when the statements are to be prepared, this unentered payroll must be taken up. This will be done through the Journal, by debiting the various necessary accounts and crediting a liability account of Wages Accrued. The liability account appears upon the Balance Sheet. At the beginning of the next period, the above Journal entry would be reversed, and the first payroll of the new period would be passed through the books in the usual way.

§ 283. Manufacturing Accounts and the General Books

A cost system, to be successful, must form an integral part of the general bookkeeping system. One of the chief requisites of a good cost system is a going inventory. Without this, it is impossible to set up a Balance Sheet, a Manufacturing Statement, and a Profit and Loss Statement without taking a physical inventory.

Since the books kept in a factory should be articulated with those in the general office, the three factors entering into costs,—material, labor, and indirect expense,—must show up on the general books as General Ledger accounts.

The Stores account in the General Ledger has the same relation to the various accounts kept with each of the kinds of raw stock carried that a customers' ledger controlling account bears to the various individual accounts of the customers. The balance in the Stores account at the beginning of any period should equal the total of the values of all stores on hand. When materials are purchased, the Stores account would be debited for the total and the various accounts with commodities in the Stores Ledger would be debited individually. When materials are drawn from stock, the Stores account would be credited in total and the Stores Ledger accounts credited in detail. At the end of each period, the Stores account should represent the inventory of all raw material on hand. The Stores account would appear as follows:

Stores

Inventory at beginning of period	$ ¢	Goods taken out during the period for work in process.....	$ ¢
Purchases during the period....	$ ¢		

If necessary to subdivide the Stores account by classes of goods, as is sometimes done, there would be one Stores account for each class controlling its own group of detail stock records.

The next General Ledger account necessary is that of Work in Progress, or Manufacturing. In the same manner as the Stores account controls the raw material, so will the Work in Progress account control the manufacturing of each article or group of articles. Under all conditions, this account will contain three essential elements,—material, labor, and manufacturing overhead.

The Work in Progress account will be debited for materials, labor and overhead applied to work in process of manufacture, and will be credited for the value of goods completed and transferred to finished stock. The balance of the account should represent the cost value of unfinished goods. The Work in Progress account will appear as follows:

Work in Progress

Inventory at beginning of period $ ¢	Finished goods at cost taken out $ ¢
Material (from Stores).... ...$ ¢	
Labor .... $ ¢	
Indirect Expenses............. $ ¢	

If necessary, this account may be subdivided into two or more as desired, each one covering the work in progress of one manufacturing department. The account may contain the manufacturing cost of articles which are not to be sold, but which are to be used by the factory, as new machinery, fixtures, etc. If the finished goods are to be sold, the credit to the Work in Progress account will be offset by a debit to the Finished Goods account. If the goods or articles are not to be sold, the offsetting debit will be to certain asset accounts, provided such articles increase the asset value of the plant permanently. Also, at times, repair work done by one department for another may be passed through this account.

When goods have been manufactured and are ready for sale,—to be handed over to the selling department, it is usual to take their cost value out of the Work in Progress account and to carry these values in a Finished Goods account. This account is a General Ledger account, a controlling account showing the total cost value of all manufactured goods ready for sale. Each class of article manufactured may have a separate detail stock account provided for it. It is not good practice,

as a rule, to carry the finished goods in the Work in Progress account until sold. The Finished Goods account would appear as follows:

Finished Goods

Inventory at beginning of period	$ ¢	Goods sold at cost.............	$ ¢
Goods manufactured at cost....	$ ¢		
Goods returned by customers at cost	$ ¢		

The General Ledger will have an account with Payroll. Direct labor is directly related to the cost of a given article and indirect labor becomes a part of the factory overhead. The Payroll account upon the General Ledger is as follows:

Payroll

Weekly payrolls	$ ¢	Direct labor to work in progress	$ ¢
		Indirect labor to factory overhead	$ ¢

The General Ledger will contain an account with Factory Overhead to hold those indirect items which are necessary to the carrying on of a manufacturing enterprise. Some of these items may be specifically applied against departments, and some may be known only in total amounts and can only be apportioned against the product in an arbitrary manner. The manner of such apportionment is a subject of much dispute, properly discussed only in a course in cost accounting; therefore, not to be discussed in the present brief discussion. The account is debited with all items of indirect expense and is credited with all amounts charged to work in progress or to finished goods. The account would appear as follows:

Factory Overhead

Unapplied balance at beginning of period	$ ¢	Indirect expenses applied to work in progress or to finished goods	$ ¢
Indirect labor from payroll account	$ ¢		
Departmental expenses.........	$ ¢		
General expenses, such as taxes, rent, depreciation, etc........	$ ¢		

One other account should be used, that of Cost of Sales. This account collects the cost of the goods sold, at the values at which they have been carried in the Finished Goods account previous to actual shipment. When goods have been returned by customers, the cost price thereof would be credited to the account. The account is shown below:

Cost of Sales

Value of goods sold at cost....	$ ¢	Value of goods returned at cost.	$ ¢

This account, as a rule, is kept open until the end of the fiscal period. Then when the inventories of finished goods and goods in process have been taken, it will be adjusted to correct any existing variations. Eventually, the account is closed to Profit and Loss.

To summarize what has been said in this section, the following Journal entries are presented:

1. Stores (or Raw Material)	$ ¢	
To—Accounts Payable (or Cash)		$ ¢
To record purchases made and taken up in the stores record.		
2. Payroll	$ ¢	
To—Cash		$ ¢
To record amount of payroll for period. If not all paid, part of credit will be to Payroll Accrued or to Factory Payroll Unpaid.		
3. Factory Overhead	$ ¢	
To—Payroll (for indirect labor)		$ ¢
Accounts Payable (for expense bills)		$ ¢
To record indirect expenses.		
4. Work in Progress	$ ¢	
To—Payroll (for direct labor)		$ ¢
Stores (or Raw Materials)		$ ¢
Factory Overhead (for portion consumed)		$ ¢
To record cost of manufacturing.		
5. Finished Goods	$ ¢	
To—Work in Progress		$ ¢
To record value of goods manufactured transferred to sales department.		
6(a). Accounts Receivable (or Cash)	$ ¢	
To—Sales		$ ¢
To record value of goods sold at sales price.		

(b). Cost of Sales....................................	\$ ¢	
To—Finished Goods....................................		\$ ¢
To record value of goods sold at cost.		
7(a). Sales (or Sales Returns)................................	\$ ¢	
To—Accounts Receivable (or Cash)......................		\$ ¢
To record at selling prices goods returned by customers.		
(b). Finished Goods..	\$ ¢	
To—Cost of Sales....................................		\$ ¢
To record at cost prices goods returned by customers. It might be that on account of damage or deterioration the amount here will be less than cost price.		

It should be remembered that the present discussion merely presents the basic principles underlying manufacturing accounts and the control of cost accounts upon the general books. A detailed discussion of cost accounts must be taken up in a separate course. Cost accounting is a difficult subject and its subject matter has been reserved for a later course, that of cost accounting.

§ 284. Illustrative Problem

The following problem and its solution are given to present the principles discussed above. A thorough study of the solution will prove beneficial for future work in this and following courses.

Problem. On January 1, 1914, The Arlington Company's records show the following conditions of its accounts:

Inventory of raw materials, \$46,864.26; accrued factory payroll, applied and distributed, \$2,495.34; goods in process at prime cost, \$191,665.32; the further value of \$24,111.51 for the factory overhead, also \$36,224.76 to cover superintendence; finished goods in stock show a total cost of \$64,968.03.

During the period from January 1 to December 31, 1914, purchases of raw materials amounted to \$241,-249.35; factory payrolls, \$377,381.70; superintendence, \$114,300; factory expenses, including wages not applied

to cost accounts, $74,538; interest paid on notes, $3,600; dividends received, $15,012.

During the period mentioned, the operation in the factory comprised: raw materials requisitioned for consumption, $239,461.02; wages applied and distributed to manufacturing cost, $360,751.20, and to factory expenses, $17,878.17, included in the sum stated in the paragraph above.

There were also forwarded from the factory to the warehouse, finished goods at prime cost, covering materials, $235,627.74, and labor, $355,001.25. The cost of goods sold during the year was $755,849.70, and the proceeds from goods sold, $907,019.64.

On December 31, 1914, the goods in process included, in addition to prime cost, factory overhead amounting to $25,317.06, and superintendence $38,035.98, and accrued factory payroll, applied and distributed, amounting to $3,743.01.

Show the cost controlling accounts as they would appear in the general ledger, their operation, and the resulting net profit. (C.P.A.)

Solution. The first step is to open the General Ledger cost controlling accounts that show balances as on January 1, 1914. These initial balances are as follows:

	Debits	*Credits*
Inventory of Raw Materials	$ 46,864.26	
Goods in Process:		
Prime Cost	191,665.32	
Factory Overhead	24,111.51	
Superintendence	36,224.76	
Inventory of Finished Goods	64,968.03	
Factory Payrolls Unpaid		$ 2,495.34

The second step would be to take the transactions as shown and make the proper entries therefor in the accounts, being careful to preserve equilibrium. To facilitate an understanding of the Ledger accounts, the

following Journal entries are shown, these being keyed to the Ledger accounts as called for in the problem.

1. Raw Materials	$241,249.35	
To—Accounts Payable		$241,249.35
To record purchases.		
2. Factory Payrolls	374,886.36	
To—Factory Payrolls Unpaid		374,886.36
To record payrolls for period. ($377,381.70—$2,495.34)		
3. Factory Payrolls Unpaid	377,381.70	
To—Cash		377,381.70
To record payment of same.		
4. Superintendence	114,300.00	
To—Cash		114,300.00
To record same.		
5. Factory Expenses	74,538.00	
To—Cash		74,538.00
To record same.		
6. Interest Expense	3,600.00	
To—Cash		3,600.00
To record same.		
7. Cash	15,012.00	
To—Dividends Received		15,012.00
To record same.		
8. Goods in Process, Prime Cost	239,461.02	
To—Inventory Raw Materials		239,461.02
To record raw materials requisitioned.		
9. Goods in Process, Prime Cost	360,751.20	
To—Factory Payrolls		360.751.20
To record wages applied and distributed.		
10. Factory Expenses	17,878.17	
To—Factory Payrolls		17,878.17
To record wages applied and distributed.		
11. Finished Goods in Warehouse	590,628.99	
To—Goods in Process, Prime Cost		590,628.99
To record transfer of finished goods from factory to warehouse:		
Materials $235,627.74		
Labor 355,001.25		
As above $590,628.99		
12. Cash	907,019.64	
To—Sales		907,019.64
To record proceeds from goods sold.		
13. Cost of Sales	755,849.70	
To—Finished Goods		755,849.70
To record cost of goods sold.		

14. Factory Overhead Expense....................	92,416.17	
To—Factory Expense......................		92,416.17
To close factory expense account.		
15. Finished Goods..............................	91,210.62	
To—Factory Overhead Expense.............		91,210.62
To close above amount of overhead out so that balance in overhead account is as called for, $25,317.06.		
16. Finished Goods	112,488.78	
To—Superintendence		112,488.78
To close above amount of superintendence out so that balance in said account is as called for, $38,035.98.		
17. Factory Payrolls............................	3,743.01	
To—Factory Payrolls Unpaid...............		3,743.01
To record accrued factory payroll applied and distributed.		
18. Profit and Loss.............................	759,449.70	
To—Interest Expense......................		3,600.00
Cost of Sales.........................		755,849.70
To close.		
19. Dividends Received..........................	15,012.00	
Sales	907,019.64	
To—Profit and Loss.......................		922,031.64
To close.		

The posting of the above entries should then be made to the Ledger accounts. The Ledger accounts are as follows:

Inventory of Raw Materials

1914			1914		
Jan. 1	Balance	$ 46,864.26	Dec.31	Goods in Process,	
Dec.31	Purchases .. (1)	241,249.35		Prime Cost (8)	$239,461.02
				Balance	48,652.59
		$288,113.61			$288,113.61
1915					
Jan. 1	Balance	$ 48,652.59			

Goods in Process—Prime Cost

1914			1914		
Jan. 1	Balance	$191,665.32	Dec.31	Finished Goods.	$590,628.99
Dec.31	RawMaterial (8)	239,461.02		Mat. $235,627.74	
	F. Payroll .. (9)	360,751.20		Lab. 355,001.25	
				(11) $590,628.99	
				Balance	201,248.55
		$791,877.54			$791,877.54

1915					
Jan. 1	Balance	$201,248.55			

Factory Overhead

1914			1914		
Jan. 1	Balance	$ 24,111.51	Dec.31	Fin. Goods (15)	$91,210.62
Dec.31	F. Expense (14)	92,416.17		Balance, unapplied	25,317.06
		$116,527.68			$116,527.68
1915					
Jan. 1	Balance	$ 25,317.06			

Superintendence

1914			1914		
Jan. 1	Balance	$ 36,224.76	Dec.31	Fin. Goods (16)	$112,488.78
Dec.31	Cash ...... (4)	114,300.00		Balance, unapplied	38,035.98
		$150,524.76			$150,524.76
1915					
Jan. 1	Balance	$ 38,035.98			

Inventory of Finished Goods in Warehouse

1914			1914		
Jan. 1	Balance	$ 64,968.03	Dec. 31	Cost of Sales .... (13)	$755,849.70
Dec.31	Goods in Process, Prime cost (11)	590,628.99		Balance	103,446.72
	Mat. $235,627.74				
	Lab. 355,001.25				
	$590,628.99				
	F. overhead (15)	91,210.62			
	Superin.... (16)	112,488.78			
		$859,296.42			$859,296.42
1915					
Jan. 1	Balance	$103,446.72			

Factory Payrolls Unpaid

1914			1914		
Dec.31	Cash ...... (3)	$377,381.70	Jan. 1	Balance	$ 2,495.34
	Balance	3,743.01	Dec.31	F. Payrolls. (2)	374,886.36
				F. Payrolls. (17)	3,743.01
		$381,124.71			$381,124.71
			1915		
			Jan. 1	Balance	$ 3,743.01

Accounts Payable

1914			1914		
			Dec.31	Raw Material .... (1)	$241,249.35

Factory Pay Rolls

1914			1914		
Dec.31	F. P. Unpaid (2)	$374,886.36	Dec.31	G. in Process,	
	F.P.Unpaid (17)	3,743.01		Prime Cost (9)	$360,751.20
				F. Expenses (10)	17,878.17
		$378,629.37			$378,629.37

Cash

1914			1914		
Dec.31	Div.Recd. .. (7)	$ 15,012.00	Dec.31	F. P. Unpaid (3)	$377,381.70
	Sales ..... (12)	107,019.64		Superin. ... (4)	114,300.00
				F. Expenses. (5)	74,538.00
				Int. Expense (6)	3,600.00

Factory Expenses

1914			1914		
Dec.31	Cash ...... (5)	$ 74,538.00	Dec.31	F.Overhead (14)	$ 92,416.17
	F. Payrolls. (10)	17,878.17			
		$ 92,416.17			$ 92,416.17

Interest Expense

1914			1914		
Dec.31	Cash ...... (6)	$ 3,600.00	Dec.31	Profit & L. (18)	$ 3,600.00

Dividends Received

1914			1914		
Dec.31	Profit & L.. (19)	$15,012.00	Dec.31	Cash ...... (7)	$15,012.00

Sales

1914			1914		
Dec.31	Profit & L. (19)	$907,019.64	Dec.31	Cash ..... (12)	$907,019.64

Cost of Sales

1914			1914		
Dec.31	F. Goods.. (13)	$755,849.70	Dec.31	Profit & L. (18)	$755,849.70

Profit and Loss

1914			1914		
Dec.31	Int. Expense (18)	$ 3,600.00	Dec.31	DividendsR. (19)	$15,012.00
	Cost of Sales (18)	755,849.70		Sales ..... (19)	907,019.64
	Balance, Net Profit	162,581.94			
		$922,031.64			$922,031.64
			1915		
			Jan. 1	Balance	$162,581.94

On December 31, 1914, the balance of the cost controlling accounts will be as follows:

	Debits	Credits
Inventory of Raw Materials	$ 48,652.59	
Goods in Process:		
Prime Cost	201,248.55	
Factory Overhead	25,317.06	
Superintendence	38,035.98	
Inventory of Finished Goods	103,446.72	
Factory Payrolls Unpaid		$ 3,743.01

§ 285. Form of Revenue Statement

In the first course in the chapter on the Statement of Profits and Income, it was noticed that a trading concern may separate its Profit and Loss account into two sections, a Trading account and a Profit and Loss account, the better to segregate the gross profit from the net profit. In a manufacturing concern, it was stated that a third section was made use of,—that of the Manufacturing account, in order to set out the cost of manufacturing by itself. This subdivision should be borne in mind at the present time. The Statement of Profits and Income for a manufacturing concern follows this same subdivision, whether in the account form or in the running form. The account form of such a statement is illustrated below:

Manufacturing Account

Inventory of Raw Material, Goods Process and Finished Parts at the beginning of the period	Inventory of Raw Material, Goods in Process and Finished Parts at the end of the period
Purchases	Balance, Cost of Manufacture carried down to the Trading Account
Productive Labor	
Factory Expenses (itemized)	

Trading Account

Cost of Manufacture carried down from the Manufacturing Account	Inventory of Finished Goods at the end of the period
Inventory of Finished Goods at the beginning of the period	Sales (net)
Purchases of Finished Goods	
Balance, Gross Profit carried down to the Profit and Loss Account	

Profit and Loss Account

Selling Expenses (itemized)	Gross Profit carried down from the Trading Account
General and Administrative Expenses (itemized)	Discount on Purchases
Interest Paid	Interest Received
Discount on Sales	Other Income
Bad Debts	
Other Expenses	
Balance, Net Profit carried to Surplus Account	

Surplus

Dividends Declared	Balance at beginning of period
Balance at end of period	Net Profit carried down from Profit and Loss Account

The Manufacturing account segregates all the items entering into the cost of manufacture. The Trading account segregates the items entering into the determination of gross profit on sales. Selling expenses should not be entered in the Trading account because the Trading account should include only the actual cost of the goods sold and the net value realized from their sales. When selling expenses are included in the Trading account, as is sometimes done, the balance is trading profit, not gross profit. The Profit and Loss section shows on the debit side the selling, general and administrative, and other expenses, and on the credit side the gross profit brought down from the Trading account, and all the other income of the period. The balance of this section represents the net profit for the period. The amount of this net profit may be transferred, as in the illustration above, to an Appropriation section (called Surplus in the above illustration). This section indicates the disposal made of the net profit.

At the present time, the exact accounts to be included in each section is an unsettled matter, some accountants advocating one solution and some another. Selling expenses may be included in the Trading section by some; such practice hides the amount of the gross profit. Some accountants consider purchase dis-

counts as a deduction from the cost of purchases, crediting their amount to the Manufacturing section. This practice seems erroneous because purchase discounts are only secured if the administration end of the business is able to find the necessary capital to pay the bills within the discount date. Therefore, the securing of a discount is a financial earning, not a reduction of manufacturing cost. Those who hold that purchase discounts represent a reduction in manufacturing cost, say that sales discounts are a reduction of sales and as such are shown in the Trading account. Others consider them as selling expenses; and others consider them in the light of the same reasoning as was applied to purchase discounts above,—as a financial expense. Other items concerning which there is a difference of opinion as to location in the Statement of Profits and Income are:

Depreciation
Insurance
Taxes
Interest on capital and on borrowed money
Rent when property is owned and not leased
Etc.

We shall pass this discussion at the present time and advise the student to choose one way of handling these items and follow that method in all cases where possible to do so; this will avoid confusion.

APPENDIX

QUESTIONS AND PROBLEMS

APPENDIX

CHAPTER I

Questions and Problems

1. What is the proper course of procedure in taking charge of the bookkeeping of a firm that has either no books of account or very imperfect ones? (C. P. A.)
2. Define and differentiate:
   (a) Fixed assets and cash assets.
   (b) Fixed liability and floating indebtedness.
   (c) Fixed charges and operating expenses. (C. P. A.)
3. (a) What is meant by a "classification of accounts"?
   (b) What different plans or bases are there for classifying accounts?
   (c) Illustrate.
   (d) Show by chart or outline the various divisions and sub-divisions of all asset, liability, income, and expenditure accounts.
   (e) What are the advantages obtained from numbering accounts?
   (f) Name and briefly describe two methods of numbering or lettering accounts. (C. P. A.)
4. On the theory that accounts may fall into the following classifications:
   (a) Accounts with individuals.
   (b) Accounts with things.
   (c) Accounts with forces or ideas.

   Give a number of illustrations or names of accounts in a modern accounting system under each of these heads. (C. P. A.)
5. The following list of accounts was handed to you with the request that against each one you write the main grouping and sub-grouping in which each will fall so that the exact classification of each account is indicated.
   Care of grounds
   Income from renting workmen's cottages
   Delivery trucks
   Sale of raw materials
   Advertising (large amounts paid for future service)
   Bonded indebtedness
   Development expenses
   Notes receivable
   Copyrights
   Royalties paid on office equipment
6. Compare a simple arrangement of accounts, as for example, Capital, Cash, Merchandise, Personal, Expense, Profit and Loss, with some other scheme of accounts expanded to meet the demands of present day requirements. Describe the possibilities and advantages of the more modern scheme. (C. P. A.)
7. In the opening of a ledger, what principle should be followed in the order of arrangement of the accounts? Show the advantages of different plans. (C. P. A.)

8. Give fully your understanding of (a) receipts, (b) revenue. Show wherein they differ. (C. P. A.)
8a. Name and define (a) the two classes of receipts, (b) the two classes of expenditures. (C. P. A.)
9. What is your understanding of the terms Capital and Revenue Expenditure?
10. An alteration to existing equipment is made in a factory. State what you would do with the cost of such alteration. (C. P. A.)
11. State which of the following should be charged or credited to capital and which to revenue:
    (a) Repairs to machinery and plant.
    (b) Replacements of machinery and plant.
    (c) Royalties on machines owned and used by the company owning the patents, similar machines being leased under royalty to competitors.
    (d) Brokerage on a piece of property purchased.
    (e) Costs attending a mortgage given.
    (f) Costs of patents, including lawyer's charges and government fee.
    (g) Expenses of incorporating a company.
    (h) Discount on bonds sold.
    (i) Premium on bonds sold. (C. P. A.)
12. Can or cannot, a going concern, employing a salaried manager and superintendent, charge any part of their salaries to cost of improvements or extensions that may be added to the plant at intervals? In either view, why?
13. A company purchased several machines and, in order to install them to the best advantage, old machines which are to remain in use were moved to make room for them. The machines were large and had to be taken apart before they could be moved. To what account would the cost of moving be charged and why? (C. P. A.)
14. A concern needs an addition to its plant. Not having enough ready capital, they borrowed money and when the interest was paid it was charged to the "Plant" account on the theory that it was not an expense in the ordinary conduct of the business and should therefore not be charged to the regular Interest and Discount account but might with propriety be charged as a part of the cost of the addition. Is the theory sound? (C. P. A.)
15. It has been stated that "Revenue expenditures do not create assets." What is your opinion?

Problem 1

Brown erects a business block at a cost of $100,000; at the end of the of the year he finds that the rents from the stores in the building amounted to $7,500; offices, $3,750. The expenses for the year were as follows: Janitor, $750; repairs and alterations, $500; water and gas, $400; taxes, $1.97 ½ per 100, on an assessed valuation of $87,000; incidental expenses, $150.

Prepare statement showing results of the year's business and per cent. of profit on capital invested, charging 5% interest on investment and $2,500 for depreciation. (C. P. A.)

Problem 2

Classify and group the following accounts of a manufacturing company according to kind of asset, liability, loss and gain:

1. Accounts payable
2. Accounts receivable
3. Accrued salaries and wages
4. Advertising
5. Bad debts written off
6. Bills payable

7. Bills receivable
8. Bond discount
9. Bond premium
10. Bond Interest accrued
11. Capital stock
12. Cash
13. Credit department expenses
14. Depreciation of buildings
15. Depreciation of workmen's cottages
16. Directors' fees
17. Discount on purchases
18. Discount on sales
19. Federal corporation tax
20. First mortgage bonds
21. Freight and cartage inward
22. Freight and cartage outward
23. General office expenses
24. Good-will
25. Insurance
26. Insurance premiums unexpired
27. Interest on bills payable
28. Interest on bonds
29. Income from investments
30. Inventory, raw materials
31. Inventory, goods in process
32. Inventory, manufactured goods
33. Investments (outside)
34. Maintenance of buildings, machinery, and plant
35. Maintenance of workmen's cottages
36. Manufacturing power, heat and light
37. Miscellaneous factory expenses
38. Miscellaneous selling expenses
39. Non-productive labor
40. Office equipment
41. Office salaries
42. Officers' salaries and expenses
43. Organization expenses
44. Patent rights
45. Patterns and drawings
46. Plant site
47. Plant buildings
48. Plant machinery and equipment
49. Productive labor
50. Purchasing department expenses
51. Raw materials purchased
52. Rent of workmen's cottages
53. Reserve for depreciation of buildings, machinery and plant
54. Reserve for depreciation of workmen's cottages
55. Reserve for doubtful accounts
56. Reserve for sinking fund
57. Returns and allowances on purchases
58. Returns and allowances on sales
59. Sales of manufactured goods
60. Sales of waste material
61. Sales agents' commissions
62. Salesmen's salaries
63. Salesmen's expenses
64. Sinking fund investments
65. Surplus
66. Taxes on plant and equipment
67. Taxes accrued
68. Workmen's cottages

(C. P. A.)

PROBLEM 3

The following is the trial balance of Bailey & Co. as taken from their ledger December 30, 1905:

Cash	$ 3,112	
Bills receivable	14,900	
Accounts receivable	22,750	
Bills payable	......	$ 2,006
Accounts payable	......	9,121
Loans @ 6%	......	5,000
Warehouse receipts	8,351	
Merchandise inventory	28,900	
Store property	20,000	
Mortgage on store property @ 5%	......	10,000
Unimproved real estate	6,000	
Store fixtures	5,000	
Depreciation on store fixtures (1904)	......	500
Horses and wagons	2,500	
Capital stock, 750 shares at $100	......	75,000
Profit and loss, surplus	......	2,573
Purchases	132,251	

Sales	......	152,439
Discounts	......	103
Rents, hall over store	......	250
Taxes	156	
Interest	800	
Heat and light	375	
Salesmen and wages of employees	4,912	
Officers' salaries	4,000	
Miscellaneous expenses and losses	2,985	
	$256,992	$256,992

Merchandise inventory Dec. 30, 1905, $30,254.

Prepare a trading and profit and loss account for the fiscal year 1905 and a balance sheet as at the close thereof. Reserve 1% of the open accounts receivable to cover bad debts, a further 10% from office furniture and 20% from horses and wagons to cover depreciation. (C. P. A.)

CHAPTER II

Questions and Problems

1. Define the following:
   (a) Boston (or tabular) ledger
   (b) Journal ruled ledger
   (c) Constructive accounting

1a. Define the following:
   (a) Private ledger
   (b) Private journal
   (c) Private ledger controlling account

2. Enumerate the classes of activity into which constructive accounting may be divided. What relation does each bear to the other?
3. What basic principles would you set out to guide one in determining whether or not an existing system of accounts is adequate and satisfactory?
4. What is the advantage of placing both money columns together in a ledger?

4a. Describe and illustrate at least three forms of ledgers adapted to customers' accounts and state the form you prefer for some specific class of accounts. (C. P. A.)

5. How should entries be made of notes receivable in the accounts of a customer whose credit is limited to a fixed maximum, so that his account will show at all times the amount for which an order may be accepted? (C. P. A.)
6. Give the ruling of a tenants' charge book to be used in a real estate office. It is desired that the book be so arranged that the amount of arrears be known monthly, as well as the charges for the current month for rent, electricity, and telephone extension and service. The monthly statement of collections is to be established from this book. (C. P. A.)
7. Rule a ledger for a country club which charges an entrance fee of $100, whose monthly dues are $15, which charges extra sums for special privileges, and which fines the members (entering them on ledger) when they fail to pay their dues.
8. You are called on to assume the duties of general clerk and book-

keeper in an establishment where accounting has been very meager and primitive. State the steps that you would take to reform existing conditions. (C. P. A.)

9. (a) What is a controlling account?
   (b) Name the uses to which such an account can be put.
10. What do you understand by a self-balancing purchase ledger? Describe fully the method of keeping it. (C. P. A.)
11. Does any advantage attach to the employment of more than one volume for the ledger of a business requiring only one bookkeeper? Give reasons. (C. P. A.)
12. Do you approve of a business concern keeping more than one Ledger? If so, why, and how would the different ledgers be characterized? What advantages do you see in loose leaf ledgers and in what kinds of business would they be useful? Under what circumstances would you advise the use of card ledgers? (C. P. A.)
13. Explain the purpose and manner of keeping a private ledger as part of the financial books of a firm or corporation. (C. P. A.)

13a. Explain how you would install for a large concern a system of bookkeeping arranged so that only the proprietor or officers of the company, together with their auditor (a C. P. A.) shall be cognizant of its financial condition and annual profits or losses. (C. P. A.)

14. What accounts should be embodied in the private ledger to make it a complete synopsis of the business? How would you prove the correctness of the accounts? (C. P. A.)

14a. Describe fully the operation of the controlling account expedient used in connection with a private ledger. (C. P. A.)

15. Assume that the private ledger of a trading copartnership contains: the capital assets and liabilities, the partners' accounts, the profit and loss account, and the notes payable account. State the procedure for closing the general ledger. (C. P. A. adapted.)

Problem 1

The Sea Side Bank having 9,000 depositors' accounts, on which the bank allows 2% interest on daily balance, requires a form for its depositors' ledger that will enable the bank officers to ascertain accurately and quickly the depositors' balance including the accrued interest.

The following items are to be incorporated in the form submitted:

Deposits, July 1, \$5,000, October 1, \$50, November 1, \$60
Withdrawals, July 1, \$4,245

Submit the form and calculate the interest to meet the requirements as of January 1, following. (C. P. A.)

Problem 2

A balance sheet drawn from the general ledger of A. Osgood, on December 31, 1918, is as follows:

A. Osgood
Balance Sheet
December 31, 1918

Assets		Liabilities and Capital	
Cash	\$ 2,000.00	Accounts Payable	\$ 1,500.00
Accounts Receivable	12,000.00	Notes Payable	4,000.00
Notes Receivable	3,000.00	Mortgage Payable	3,000.00
Inventory	8,000.00	A. Osgood, Capital	20,000.00
Furniture and Fixture	3,500.00		
	\$28,500.00		\$28,500.00

On January 2, 1919, Mr. Osgood desires to open a private ledger to be kept in his personal possession. He wishes to keep therein the following accounts:

Inventory
Furniture and Fixtures
Mortgage Payable
A. Osgood, Capital

On July 1, 1919, Mr. Osgood makes an additional investment of $5,000 in the business, which amount he deposits in the bank.

On September 1, 1919, Mr. Osgood pays off his mortgage debt

Required:

1. Entries to open the books on the new system.
2. Entries to record subsequent transactions.
3. Trial balance of each ledger after each step is completed.

PROBLEM 3

A & B, as copartners, have carried on the business of manufacturing toys, and at the close of the year 1915 their books disclose the following balances: A Drawings, $3,900; B Drawings, $3,900; Factory Expense, $25,974.31; Sales, $127,259.44; Discounts Received, $523.42; Discounts Given, $5,782.23; Traveling Expense, $1,585.80; Interest Received, $635.17; Interest Paid, $797.93; General Expense, $7,468.26; Insurance, $389.68; Merchandise Account, $80,242.67 (including inventory January 1, 1915, of $29,035.79); Fixtures, $5,072.70; Notes Payable, $15,000; A. Capital Account, $16,892.92; B. Capital Account, $26,892.92; Investment Account, $5,689.50; Goodwill, $8,107.09; Reserve for Depreciation of Fixtures, $1,152.48; Reserve for Uncollectible Accounts, $273.45; Dies, Patterns, etc., $1,000; Cash, $18,935.66; Accounts Payable, $3,407.18; Accounts Receivable, $23,191.15.

The inventory December 31, 1915, amounts to $24,908.79; 10% depreciation is to be charged on Fixtures; interest has been paid on the notes at 6% to January 16, 1916; unexpired insurance, $125.62. A sufficient charge is to be made to increase the Reserve for Uncollectible Accounts to $598.54.

Required:

1. Trial balance before closing.
2. Profit and loss statement for the year.
3. Balance sheet December 31, 1915.

CHAPTER III

QUESTIONS AND PROBLEMS

1. Define the following terms:
   (a) Cash
   (b) Discount
   (c) Trade discount
   (d) Cash discount

1a. Distinguish and explain:
   (a) Disbursements
   (b) Cash disbursements (C.P.A.)

2. Describe the use and operation of a clearing house. (C.P.A.)

3. A company issues annually over 10,000 checks on three separate banks,

recording each one on the check stub and then transcribing each check in detail on the general cash book. Suggest a change in method which would facilitate the work and point out advantages gained. (C. P. A.)

4. The cash book of a firm showed at a given date a balance available by their bankers amounting to $10,000. Their bank pass book, however, showed a balance of $10,010 at credit, the firm having deposited in checks $3,264, which had not been collected by the bank and for which no credit had been given. Also having issued various checks as follows, which had not been presented for payment, viz.: In favor of John Smith, $200; Edward Roberts, $400; Peter Simpson, $750; Alfred Styles, $586; J. Thompson, $182; Thomas Stevens, $241; Charles Milbourne, $346; Richard Higgins, $150; T. Phillips, $125; J. Edgers, $294. Prepare a statement reconciling the cash book and the pass book.

4a. The balance of cash on hand at the date of audit according to the cashbook and ledger is $15,906.27; the bank passbook on the same date shows a balance of $16,527.02. Which amount should appear on the balance sheet? Why?

5. What is the best method of handling cash receipts and disbursements, and what advantages result from such method? (C. P. A.)

6. What plan would you suggest to minimize the risk of fraud in the "Accounting of cash receipts"? (C. P. A.)

7. Describe completely a method of handling cash receipts, say, in a wholesale establishment, doing a mail order business.

8. What general principles should govern a public accountant in the establishment of a system of accounts in any business? (C. P. A.)

9. What are the advantages of using a petty cash fund?
Briefly, how does such a fund operate?
Present illustrative entries for wiping out such a fund, the petty cashier turning over expense vouchers and the remaining cash balance.

9a. Where a petty cash account is used, operated on the imprest basis, how can postage stamps received in payment of small invoices be handled?

10. The Carson Trading Company establishes a working fund of $400 which it advances to one of its salesmen for his expenses while on the road. Whenever the salesman sends in his expense report, the company forwards him a check to cover the amount shown therein. The company closes its books and prepares its statements on June 30, and on December 31. An expense account was received from this Salesman on June 30, but was not entered upon the books until July 6, at which time a check was drawn for the amount called for and charged to "Salesmen's Traveling Expenses" account.
Was this procedure correct? If correct, why? If not, why not?

11. A certain piece of machinery is bought at a cash discount. You, as an accountant, are asked to pass upon the two following suggested methods of handling the transaction:
    (a) The machinery account should be charged with the full purchase price of the machine, the bank account should be credited with the amount of the check, and the discounts earned account should be credited with the discount received.
    (b) The machinery account should show only the absolute net amount paid for the machine, no entry being made for the discount received.

11a. Illustrate some of the methods of calculating trade discounts.

12. State your reasons in favor of and opposed to the use of card, loose leaf,

and permanently bound records respectively, under various conditions and circumstances. (C. P. A.)

13. Describe several economies in accounting made possible by the introduction of special columns in books of original entry. (C. P. A.)
14. (a) Differentiate between a statement of income and expense, and a statement of receipts and disbursements.
    (b) The annual report of a club contains both statements. You find that the items and figures in one are identical with those in the other. Account for the situation necessary for the existence of this similarity. (C. P. A.)
15. In taking charge of a double entry set of books, you find the following condition: The accounts receivable control does not agree with the total of the accounts receivable ledger. The books have not been balanced for a long time and it would be exceedingly difficult to go over them. The controlling account balance is larger than the total of the individual ledger accounts. What would you do under the circumstances?

Problem 1

Following is a list of the accounts appearing on the trial balance of a manufacturing company which deals in finished merchandise purchased as well as in its own products. From this list, and without using figures, draw up plans of financial statements (balance sheet, manufacturing account, profit and loss account, etc.) in the form which you think most suitable:

Accounts payable
Salaries, management
Capital stock
Bills receivable
Cash
Bills payable
Salaries, office and store
Real estate
Fuel
Insurance (plant)
Light
Freight (on merchandise purchased)
Machinery and tools
Freight (on raw materials)
Buildings
Sales (own product)
Inventory (own product)
Inventory (raw materials)
Inventory (partly manufactured goods)
Inventory (merchandise purchased)
Inventory (repair supplies)
Sales (merchandise purchased)
Undivided profits (end of last year)
Purchases (merchandise)
Rent, factory
Rent, store and office
Printing and stationery

Accounts receivable
Advertising
Purchases (raw material)
Machinery repairs
Productive labor (factory)
Labor (warehouse)
Office furniture
Reserve for bad and doubtful accounts
Reserve for depreciation
Insurance (merchandise)
Bad and doubtful accounts
Travelers' expenses and salaries
Management salary, factory
Management salary, office
Discounts allowed
Interest payable
Depreciation
Sundry factory expenses
Sundry office expenses
Postage
Subscriptions and donations
Discounts received
Rents (receivable)
Insurance unexpired, plant
Insurance unexpired, merchandise

(C. P. A.)

PROBLEM 2

The ledger of the firm of Cutter & Fitler, retail dealers in men's clothing and furnishings, showed the following balances on December 31, 1912:

	Dr.	*Cr.*
Cash	$ 2,896.14	
Accounts receivable	28,226.06	
Bills receivable	1,650.00	
Furniture and fixtures	6,344.92	
Accounts payable		$ 12,518.30
Bills payable		5,598.66
Inventory, Jan. 1, 1912:		
Clothing department	12,689.54	
Shoe department	5,219.78	
Haberdashery department	4,711.44	
Purchases:		
Clothing department	36,148.83	
Shoe department	15,291.34	
Haberdashery department	12,680.27	
Sales:		
Clothing department		54,723.57
Shoe department		23,107.82
Haberdashery department		18,560.26
Wages:		
Clothing department	2,867.50	
Shoe department	1,324.80	
Haberdashery department	987.65	
General expenses	1,834.19	
Office salaries	1,450.00	
Rent	3,000.00	
Taxes	782.96	
Insurance	387.39	
Bad debts	463.28	
Amos Cutter, capital account		20,000.00
Hiram Fitler, capital account		10,000.00
Amos Cutter, withdrawal account	3,701.68	
Hiram Fitler, withdrawal account	1,850.84	
	$144,508.61	$144,508.61

Inventories on December 31, 1912, are as follows:	
Clothing department	$ 14,466.23
Shoe department	4,913.62
Haberdashery department	5,028.96
Prepayments on that date are:	
Taxes	168.22
Insurance	57.30

There are no accrued liabilities.
Depreciation of 10% is to be written off from furniture and fixtures.
Each partner is to be credited with 6% interest on his capital.
No interest is to be charged on partners' withdrawals.
Net profit or loss to be divided: Cutter ⅔, Fitler ⅓.
Prepare the following:

1. Trading account for each department.
2. Profit and loss account.
3. Capital account of each partner.
4. Balance sheet.

(C. P. A.)

PROBLEM 3

Compute the interest equivalent of the following cash discounts from the point of view of the buyer of merchandise assuming money is worth 6% per annum:

1. $\frac{1}{10}$; n/60.
2. $\frac{2}{10}$; n/60.
3. $\frac{1}{10}$; n/30.
4. $\frac{2}{10}$; n/30.

Use $100 as basis of computation.

CHAPTER IV

QUESTIONS AND PROBLEMS

1. Define the following:
   (a) Cash book
   (b) Cash receipts register
   (c) Check register
   (d) Cash recapitulation sheet
2. Define or explain "internal check." (C. P. A.)
3. In closing the cash book at the end of the month, how should the discount received and discount allowed items be handled?
4. Prepare a form of cash book with columns covering the following:

Receipts from customers	Purchase ledger accounts
Discounts allowed	Discounts deducted
Cash sales	Petty cash
Private ledger accounts	Private ledger accounts

(C. P. A.)

5. Draft a form of cash book where all receipts are deposited in bank and all payments are made by check. (C. P. A.)
6. Rule a form of cash book suitable for a charitable institution. (C. P. A.)
7. A certain business is engaged in making loans which later are sold on a renewal basis commission, i. e., the purchaser permits the business to retain ½% of the interest rate during the life of the loan as compensation for making the loan. Interest on every loan placed is made payable at the office, which when paid by the mortgagor is turned over to the mortgagee in the form of a check, the amount given the mortgagee being the full amount of the interest received less the ½% commission.

   What provision would you make on the cash book for handling this activity?
8. A manufacturing concern desires you to install a petty cash book, a general cash book, and a private cash book. Explain the use of each cash book and give sample rulings therefor. (C. P. A.)
9. Explain the uses and relations of a petty cash book to the principal cash book. (C. P. A.)
10. A company has a main office and factories which have cash balances handled by the imprest system. The checks reimbursing the funds are entered and the distributions of the expenses are made directly through the cash book. The permanent fund of one factory is $4,000, and the expenses of one period $2,310.36. It is desired to reduce the permanent fund to $3,000.

Show exactly how and in what books the necessary entries should be made. (C. P. A.)

11. Draw up a form for the record of household accounts that may be used as a combined cash book, journal and ledger. Give the headings and provide five distribution columns for expenditures, and also columns for controlling accounts for both accounts payable and accounts receivable. (C. P. A.)

12. A wholesale fruit and produce company uses a cash journal in its business. The columns at present in use are as follows:

Customers, Dr.–Cr.	Merchandise, Dr.–Cr.
Creditors, Dr.–Cr.	Express, Dr.
Miscellaneous, Dr.–Cr.	Freight, Dr.
Cash, Dr.–Cr.	Discount, Dr.–Cr.
Bank, Dr.–Cr.	Salaries, Dr.

An autographic register is used on which customers' bills are made out. The postings are made direct from the duplicate bills to the ledger. The bills are serially numbered. For example, if a day's sales amount to $300, of which $50 represent cash sales, the following entry is made: Sales from No....... to No....... inclusive, customers column Dr. $250; cash column Dr. $50; and merchandise column Cr. $300. Bills are filed, the file being used as a sales book. Column totals are posted to the general ledger monthly. The business is not large, sales never exceeding $400 a day. The articles sold may be divided as between poultry, butter, and eggs.

Suggest any improvements that occur to you which might well be made in the above records.

13. Do you see any objection to the practice of passing journal entries through the cash book? Explain fully. (C. P. A.)

14. Is it necessary to journalize your cash receipts and payments in order to be able to balance your books kept by double entry? Give reasons.

15. The accounting department of a jobbing house, consisting of five men, keeps the books, does the billing, makes city collections, handles the general and petty cash and pays the invoices of the company. On what general lines would you distribute the work of the department for the prevention of fraud? (C. P. A.)

Problem 1

The Drawn Steel Company was formed at the beginning of the year 1918. On December 31, 1919, a trial balance drawn from the records of this company, before closing, disclosed the following balances:

Capital stock		$150,000
Land and buildings	$ 37,500	
Machinery and tools	66,000	
Raw material, January 1, 1919	19,150	
Goods in process, January 1, 1919	13,975	
Finished goods, January 1, 1919	13,125	
Automobile trucks	2,250	
Stable expense (½ selling, ½ manufacturing)	1,800	
Raw material, purchases	67,615	
Insurance, factory and contents	1,700	
Insurance, finished goods	1,200	
Shop supplies	1,025	
Advertising	9,185	
Furniture and fixtures	4,000	

Office salaries	4,375	
Salesmen's salaries	5,500	
Rent, office	1,500	
Notes payable		40,625
Interest on loans	1,685	
Freight inward, raw material purchases	3,225	
Freight outward, sales	1,575	
Repairs, machinery and tools	650	
Productive labor	32,275	
Non-productive labor	10,635	
Miscellaneous factory expense	290	
Accounts Receivable	107,035	
Accounts payable		60,600
Heat and power	2,550	
Sales		222,875
Sales returns and allowances	9,125	
Cash	8,500	
Petty cash	65	
Postage	350	
Traveling expense, salesmen	2,325	
Printing and stationery	500	
Notes receivable	37,500	
Bad debts, written off	625	
Discounts on purchases		2,000
Discounts on sales	4,000	
Miscellaneous office expense	290	
Cartage, inward (½ selling, ½ manufacturing)	3,000	
	$476,100	$476,100

The inventories on hand December 31, 1919, were: Raw material, $20,075; goods in process, $14,925; finished goods, $15,000; factory insurance, $425; goods insurance, $330; advertising, $1,100; direct labor unpaid, $2,316.31; indirect labor unpaid, $413.27; shop supplies, $50.

Depreciation per annum: buildings, 7%; machinery and tools, 12%; auto trucks, 17%; furniture and fixtures, 10%.

Required: (a) Ledger account of profit and loss properly subdivided
(b) Statement of profit and loss;
(c) Balance sheet (regular form and double account form).

Problem 2

The Energy Manufacturing Company draws on its customer, Slopay & Co., at two months from date, January 1, 1910, for $5,000 and three days thereafter discounts the draft with the City National Bank at five per cent. per annum net.

At maturity S. & Co. confess they cannot meet the draft, but pay the E. Mfg. Co. $3,000 on account, and give an acceptance for a like period for the balance, upon condition that the E. Mfg. Co. retire the original draft, which is done.

Detail serially the entries by which the E. Mfg. Co. should record these transactions on its books. (C.-P. A.)

Problem 3

The Stranger & Baxter Trading Company started business January 1, 1919, and at the close of the year you were called in to prepare statements

of operation and a balance sheet. The books were kept in a careless manner, but from various sources you were able to obtain the following information:

Capital stock	$10,000.00
Office furniture and fixtures	1,295.28
General expense	582.26
Traveling expense	1,586.00
Commissions	4,596.82
Sales	91,936.40
Due salesmen—account of commissions	935.28
Freight and cartage	1,296.32
Purchases	79,286.92
Accounts payable (Mdse. only)	12,596.82
Accounts receivable	10,983.54
Insurance	226.38
Rent	1,200.00
Salaries	1,500.00
Discounts given	1,524.86
Discounts received	1,284.26
Inventory, December 31, 1919	15,496.83
Unexpired insurance, December 31, 1919	79.84

Prepare Statement of Receipts and Disbursements, Profit and Loss Statement, and Balance Sheet.

Depreciation on furniture and fixtures, 10%.

CHAPTER V

Questions and Problems

1. Define the following:
   (a) Invoice
   (b) Voucher distribution
   (c) Bill
   (d) Vender and vendee
2. How may unpaid and paid invoices be cared for properly in an establishment by means of a vertical filing cabinet, divided into two or more sections according to local requirements?
3. State the advantages of using columns in an invoice or voucher register for distributing the expenditures. When would it be advisable to use a distribution ledger? (C .P. A.)
4. What are the advantages of purchase journals?
   How are the transactions that are recorded in such journals brought into the general ledger? (C. P. A.)
5. Prepare a ruling for an invoice book to provide for total monthly charges to three material accounts and two expense accounts, and also to detail postings to sundry accounts of capital and revenue outlay. (C. P. A.)
6. Describe a method of recording purchases that will obviate the necessity of keeping individual creditors' accounts. (C. P. A.)
7. Outline a method by which the disbursing officer in a large concern may be sure that bills which he pays are O. K. (C. P. A.)

7a. What is the best plan for distributing monthly bills among 500 or more expense and construction accounts? (C. P. A.)

8. In what way may a voucher register be considered both as a record of original entry and a record of final entry?
9. Is it possible to use a voucher system to advantage in every business? If it may be used, why? If not, why not?
10. What postings are made to the vouchers payable account on the general ledger:
    (a) When the "total" column on the voucher register holds the amount found on an invoice before deducting the cash discount?
    (b) When the "total" column on the voucher register holds the amount found on an invoice after the cash discount has been deducted?
11. How may a firm doing a business from $25,000 and up not keep ledger accounts of transactions with creditor firms even though the management wishes to know from time to time how much business is done each year with each creditor?
12. What advice would you give on the design of a voucher record where the accounts are so numerous as to make the book extremely large and unwieldy?
13. When a voucher record is kept, and there are columns for rent, salaries, insurance, etc., thereon, are those columns omitted from the cash book?
14. Draw up a form of "check register" to be used in conjunction with a complete voucher system, it being intended that the check register shall take the place of the disbursement side of the cash book and shall also record the deposits and withdrawals in three different bank accounts. Discounts on goods purchased to be handled through the voucher journal. (C. P. A.)
15. Draw up a form of cash book for a corporation where a complete voucher system is in operation and where the following conditions exist: Two country and two city ledgers are kept, also an operating ledger and a private ledger. It is a practice of a majority of the customers to take advantage of the discounts given for cash in thirty days. It is also the custom of the corporation to deduct the discount they intend to take advantage of on goods purchased by them, by means of a column in their voucher journal. Their business is such that 20% of their sales are made for cash and 10% on C. O. D's. The chief expenditures of the corporation are for woolen fabrics, notions, fuel, light and labor. (C. P. A.)

Problem 1

On December 31, 1917, the manager of a certain concern reported to the owner that he had on hand an inventory totaling $12,428.28 in amount. The owner calls you in to verify this figure From an examination of the books and records for the period between June 1, 1917, and December 31, 1917, you deducted the following information which you are convinced is correct.

Net profit for 7 months	$ 6,166.18
Total expenses for 7 months	170,008.64
Inventory, June 1, 1917	9,463.86
Sales for 7 months	146,028.15
Purchases of raw material	91,729.90
Purchases of finished goods	31,963.20
Sales of material at cost	22,296.85
Discounts received	4,890.40

Problem 2

I start in business with \$5,000 in cash. At the end of the first year my purchases, on which I am allowed 2½ per cent. discount for cash, have amounted to \$108,408.04, which I have paid for, with the exception of invoices amounting to \$7,108.04.

My sales have been \$119,212.50, of which sum \$7,107.50 are outstanding, the balance, on which I have allowed 5 per cent. discount, having been paid for in cash.

My stock consists of raw material costing \$3,756.50, and of finished goods of a selling value of \$6,458, but costing \$4,906. I have paid during the year \$6,702.87 in wages, and \$2,706.54 in salaries, rent and other expenses; and I owe \$455.56 under the latter head. I have drawn \$1,200 on account of my profits.

Construct all the ledger accounts necessary to show the foregoing transactions, and prepare a balance sheet and trading and profit and loss accounts at the end of the year, calculating interest on capital, but not on drawings, at the rate of 5 per cent. per annum. (C. P. A.)

Problem 3

The trial balance of the Jones Templar Company on December 31, 1919, was as follows:

Cash ....\$	50,100.00	Reserve for discounts on customers' accounts, 12/31/18....\$	12,000.00
Accounts receivable, gross	400,000.00	Reserve for discounts mdse. invty. 12/31/18	12,000.00
Notes receivable	30,000.00	Accounts payable	90,000.00
Merchandise inventory, 12/31/18, gross	240,000.00	Notes payable	600,000.00
Merchandise purchases, 1918	1,250,000.00	Sales	1,500,000.00
Interest prepaid, 12/31/18	12,500.00	Purchase discounts secured on settlement with creditors	59,500.00
Interest, paid to 12/31/19	36,000.00	Reserve for bad debts, 12/31/18	3,000.00
Expenses, paid to 12/31/19	156,000.00	Merchandise returned to creditors, to 12/31/19	50,000.00
Reserve for discount, accounts payable, 12/31/18	4,000.00	Collected on accounts charged off in 1918..	500.00
Bad debts charged off, to 12/31/19.........	2,500.00	Credit insurance, received on losses of 1918	1,000.00
Merchandise returned by customers	100,000.00	Profit and Loss, 12/31/18	55,000.00
Salaries	20,000.00	Capital stock.........	225,000.00
Taxes	5,000.00		
Plant	250,000.00		
Discounts allowed customers	51,900.00		
	\$2,608,000.00		\$2,608,000.00

The following notations must be considered:

Accounts payable, December 31, 1918, gross \$80,000.00.

Accounts receivable, December 31, 1918, gross \$300,000.00.

Notes payable, December 31, 1918, \$500,000.00. Interest paid at 5% to July 1, 1918.

On July 1, 1919, \$500,000.00 is renewed at 6% for one year and \$100,000.00 more was borrowed at the same rate for one year.
Inventory, December 31, 1919, \$320,000.00.
Goods have been purchased on terms of 5%, thirty days.
Goods have been sold on terms of 4%, thirty days.
Reserve for bad debts, December 31, 1919, is to be 1% of gross accounts receivable.
Required:
(a) Statement of profits and income
(b) Balance sheet

CHAPTER VI

Questions and Problems

1. You sold the Smith Mfg. Co., 2/10, n/30, a bill of goods amounting to \$792.16. The account carried with this company is a mixed creditor and customer account and is carried only upon the creditors' ledger. The general ledger contains a controlling account with accounts receivable and accounts payable.
Make the proper entries to record this sale upon the books.

1a. In classifying the items of a statement of profit and loss under what caption should "freight on sales" appear to be logically allocated? Why? (C. P. A. adapted.)

2. Describe a safe and easy system of keeping the account of goods returned, (a) as buyer, (b) as seller. (C. P. A.)

2a. Describe fully a system by which occasional small sales made on credit to persons not regular customers may be recorded without opening a separate account with each purchaser. (C. P. A.)

3. In a set of books in which a sales book and sales ledger are used, how should a sale of merchandise be treated when an accepted draft for the amount is given by the buyer? (C. P. A.)

3a. Describe a way of keeping a bills receivable book as a book of original entry from which only the credits to personal accounts are posted in detail while only the total of monthly charges and liquidations of notes are posted to the bills receivable account. (C. P. A.)

4. Suggest a plan whereby a department store might adequately control its C. O. D. business. If convenient for purposes of illustration, submit forms. (C. P. A.)

4a. A customer says that a bill which he has received from you represents goods for which he does not owe. He fails to state whether the goods were never purchased, were purchased but returned, or were purchased and paid for. What process should you go through (what books should you consult—naming them in order—and what should you look for) to determine the facts?

5. A large hotel is furnished on the installment plan. Explain, giving reason, whether the question of interest is of importance to (a) seller, (b) buyer. (C. P. A.)

5a. The Western Farm Machinery Company sells its product to farmers on three years' credit, payable in three equal annual installments. The cost of production for one year is \$10,987,600; sales, \$13,210,900; selling and administrative expenses, \$223,300, including all con-

tingencies. Find an equitable method of stating profits for the year. (C. P. A.)

6. A large manufacturing concern has most of its machinery purchased on the installment plan, in monthly payments, a bill of sale not being given until the machinery is paid in full. . . . At the close of the year there are several machines not yet paid in full. How would you treat the machinery, the installments paid, . . . in your statement? (C. P. A. adapted.)

6a. A retail book-store agrees to deliver certain sets of books at $20, on payment of $2 down, the purchaser agreeing to make $3 payments for each of the six months following. It is expected that sales on this plan will aggregate several hundred sets. Suggest a method of keeping accounts, so that results may be readily shown. (C. P. A.)

7. A trading and mining company maintains five general stores at five separate stations, and concentrates its supplies each year at Station A, which is the only one accessible by railway; distribution is made from thence by means of wagon and pack trains. The cost of goods laid down at Station A is 10% above invoice prices at the company's general office in Montana; and the agent at Station A is instructed to re-bill all shipments to Station B at 20% above original invoice cost; to Station C at 35%; to Station D at 40%; and to Station E at 50%, the experience of several years bearing out the General Manager's statement that such additions are approximately correct and cover actual cost of transportation.

In auditing the accounts for the purpose of certifying the annual balance sheet, you ascertain that certain goods at Station D amounting to $10,000 are inventoried by the agent at that point at 70% above the original invoices which you have examined at the home office. He states that Station E, being overstocked, shipped him several lots of merchandise at price billed out to E by Station A, plus 10% for estimated cost of handling and repacking at E; and to this D legitimately added 10% for cost of transportation from E back to D.

In your visit to other stations you find many similar instances where goods have been moved back and forth and each time the shipping station has added 10% for handling and repacking.

Out of a total inventory, at all stations, of goods originally costing $200,000, the summary shows final extensions of values aggregating $325,000, of which not more than $75,000 is covered by cost of transportation, leaving $55,000 represented by internal charges added between the different stations.

Review the foregoing statement and give your method of handling such accounts. (C. P. A.)

8. A company brought out a new machine, and for the purpose of getting it on the market, sent their customers a large number of machines on approval. These machines were charged in the ledger accounts of the several customers and credited to the regular sales account.

How would you deal with these items in preparing a profit and loss account and balance sheet? (C. P. A.)

8a. A company packs a coupon in each box of goods sold. The company agrees to redeem 100 coupons with premiums costing $1 apiece. 25% of the coupons are never presented for redemption.

Prepare sample journal entries for the bookkeepers to follow which will give the last of each month the expense for the month for coupons given out, the amount of premiums on hand, and the gross and net liability for outstanding coupons, and state briefly how these entries will produce the result wanted. (C. P. A.)

9. A grain dealer charges his customers 15¢ apiece for sacks that cost him 10¢ each. He agrees to receive back any sacks returned in good condition at 12¢ each, calculating that they would be worth 7½¢ each. How should these transactions be treated on the dealer's books? (C. P. A.)

9a. A is a superintendent in the employ of X & Y, a firm of manufacturers, and has an interest in the profits. On September 8, 1914, X & Y indorse A's \$3,500 note, due in six months with interest at 6%. X & Y charge the fee of 1% (\$36.05) to A's account on the firm's books. A sells this note to a private note broker. On March 10, 1915, X & Y pay \$3,607.50, inclusive of protest fees, to the holder of the note which A had permitted to be dishonored. What entries are necessary on the books of X & Y to record the transaction? (C. P. A.)

10. Describe the principal books of account of some concern with which you are familiar, and show the relation and connection of these books.

10a. Enumerate the general financial books you would recommend should be kept by a wholesale dry goods company conducting three distinct departments, viz.: silks, cottons, and woolens, in respect of which it is desired to keep the trading results separately. The company does an extensive business in all three lines, having upwards of 10,000 customers' accounts on its books. Its bills for purchases are paid promptly, except as regards some of the larger suppliers who extend long credits and accept payments on account.

Draft the form of records you would recommend should be used for recording the purchases and sales, respectively. (C. P. A.)

11. Prepare a ruling for a sales book to provide (1) total monthly postings to three goods accounts, (2) the separation of cash sales from charge sales, (3) supplementary distribution of sales among four salesmen's columns. (C. P. A.)

11a. Examination of the books of a plumbers' supply house shows that all outgoing bills are press copied and posted individually to customers' accounts, the monthly aggregate of sales being credited to merchandise account. Many customers have charges daily or oftener. What change in method can you suggest that would lead to a more intelligent statement of results, save labor and avoid congestion? (C. P. A.)

12. Illustrate a columnar cash book, a columnar journal, and a columnar sales book. What general requirements should be observed in designing these books? Give an estimate of the utility of the columnar plan. (C. P. A.)

13. A wholesale grocery house has several outdoor salesmen, both in and out of the city, who are paid commissions on their sales. What are the danger points to be noted, and how would you arrange the books and accounts to protect your client against the payment of commissions not earned? (C. P. A.)

13a. A grocery house employs a number of salesmen who act as collectors. Suggest a system that would tend to prevent defalcations on their part. (C. P. A.)

14. State in the form of a journal entry on the books of John Brown the following transaction:

Installment notes given by him on purchase of real estate; face of notes includes interest charges up to and including maturity of notes (C. P. A.)

14a. The ABC Manufacturing Company shipped a bill of goods amount-

ing to $300 to a customer, rendering the usual invoice therefor. The goods were destroyed in transit by a railway wreck. The ABC Company subsequently made a second shipment to its customer to replace the lost goods, and collected $300 from the railway company in payment of the lost shipment. To what account should this last $300 be credited? (C. P. A.)

15. A manufacturer finds that during three months his goods have cost per cent, on the sale price:

Raw Material	30
Wages	20
Rent, etc................	5
Fuel	10
General expenses..........	15
	80

What should be added to his selling price to obtain the same profit if the following advances take place?

Coal ....50% advance		
Materials ...... 5% advance		
Wages .... 2½ advance		(C. P. A.)

15a. A company operating a number of departments desires to know the profit on the sales of each department. How would you suggest the books be kept to give the management this desired information?

Problem 1

A and B are partners owning a drug store. At the end of the first year you are called upon to state the profit for the year and prepare entries to open a proper set of books. You secure the following information:

Capital contributions: A Merchandise, $2,900; Furniture and Fixtures, $2,000; Accounts Receivable, $100; Accounts Payable, $2,500; B Cash, $3,000. At the end of the first three months the partners purchase the land and building in which their business is conducted paying therefor cash $1,000 and giving a Purchase Money Mortgage for $3,500, Interest at 6% per annum payable semi-annually. They build an addition to the building at a cost of $750 for which they gave a note which was paid at its maturity by B. The interest upon the mortgage was paid by B. The partners state that they have agreed upon annual salaries of $1,200 each and to divide the profits equally. Withdrawals were, A, $750; B, $900. Cash on hand at end of year, $600. Accounts Receivable—good—$250; doubtful, $40. Merchandise, $3,250. Accounts Payable to merchandise creditors, $1,500.

State the profit. Also indicate what books you would recommend and state the entries to open same.

Problem 2

John Jones, wholesale druggist, asks you to prepare from the following information:

(a) Closing entries, June 30, 1919.
(b) Comparative balance sheet, June 30, 1919, and December 31, 1918.
(c) Statement of profits and income.

	Trial Balance December 31, 1918		Trial Balance June 30, 1919	
Cash	$ 1,081.76		$ 2,444.21	
Accounts Receivable..........	5,219.74		4,767.50	
Notes Receivable.............	1,250.00		900.00	
Inventory, June 30, 1918......	6,580.00			
Insurance Unexpired..........	80.00		82.50	
Inventory, Dec. 31, 1918.......			7,516.00	
Delivery Equipment..........	388.50		413.50	
Furniture and Fixtures.......	400.00		392.50	
Building	6,100.00		6,100.00	
Land	3,000.00		3,000.00	
Accounts Payable		$ 7,229.00		$ 4,527.22
Notes Payable		2,169.00		1,500.00
John Jones, Capital..........		14,700.00		15,807.00
John Jones, Current..........	300.00		200.00	
Sales	285.00	6,100.00	316.00	8,341.11
Purchase Discounts		237.60		273.51
Purchases	4,247.83		3,156.47	141.00
Freight Inward	252.20		206.40	
Warehouse Supplies (used)...	58.25		61.35	
Warehouse Labor	150.00		120.00	
Repairs, Furniture & Fixtures.	10.50		20.00	
Building Expenses............	45.00		31.06	
Selling Expenses	428.00		315.20	
Freight and Cartage Out......	117.32		85.56	
General Admin. Expenses......	227.50		275.45	
Insurance Expense............	9.00		7.50	
Interest Expense.............	12.50		7.00	
Sales Discounts..............	192.50		171.64	
	$30,435.60	$30,435.60	$30,589.84	$30,589.84

Notation:

Inventory, June 30, 1919, $5,231.47.

Problem 3

The following is the trial balance of the Arlington Manufacturing Co. at the close of business, December 31, 1904, the end of the second fiscal year of the company's operations:

Cash	$ 25,324	
Land	100,000	
Buildings	200,000	
Machinery	300,000	
Tools and implements.........................	40,430	
Horses, wagons and harness....................	30,000	
Office furniture	5,201	
Bills receivable	25,812	
Accounts receivable..........................	163,374	
Investments	20,000	
Salesmen's accounts, advances on salaries..........	1,960	
Organization expenses, $15,000 less 2%............	14,700	
Goodwill	200,000	
Bills payable.................................		$ 42,000
Accounts payable		98,511
Special accounts—officers and clerks...............		15,363

Reserve for bad debts—less accounts written off.....		$ 112
Reserve for depreciation—buildings 2½%..........		5,000
Reserve for depreciation—machinery 6%...........		18,000
Reserve for depreciation—Horses, wagons, etc., 10%.		3,000
Capital stock 10,000 shares at $100................		1,000,000
Sales less returns and allowances................		1,240,600
Rent of part of business premises.................		500
Inventory, December 31, 1903....................$	104,621	
Purchases, including freight and cartage...........	395,662	
Labor—factory payrolls...........................	600,400	
Salaries of officers, clerical force...................	75,120	
Salaries of salesmen..............................	60,440	
Advertising	50,300	
Taxes	4,020	
Insurance	2,600	
Interest and discount..............................	6,500	
Maintenance—repairs, buildings, machinery, horses and wagons..................................	26,942	
Profit and loss, 1903, surplus......................		60,070
Expenses, stable, office, legal, and unclassified.......	29,750	
	$2,483,156	$2,483,156

Note:

Inventory, December 31, 1904...... ....$	270,560
Factory payrolls accrued but not paid..........	5,750
Unexpired insurance.........................	912

From the trial balance and notations, prepare a trading account and a profit and loss account, writing off 2% of organization expense. After stating the net profits for the year, make the same reserves for depreciation as were made at the end of the first or preceding year. Show as a final balance at credit of profit and loss the surplus available for dividends. Also prepare a balance sheet as at December 31, 1904. (C. P. A.)

CHAPTER VII

Questions and Problems

1. Define:
   (a) Balance sheet
   (b) Statement of assets and liabilties
   (c) Statement of affairs
   (d) Reserve and surplus
   (e) Fixed charges and operating expenses
   (f) Capital receipts and expenditures
   (g) Revenue receipts and expenditures
   (h) Capital profit and capital loss (C. P. A.)

1a. Define:
   (a) Statement
   (b) Report form of statement

2. How does a trial balance differ from a balance sheet? (C. P. A.)

2a. What are capital assets? The stockholders of a certain company for which you are the accountant ask you to explain why you have signed the company's balance sheet as correct when therein the capital assets are shown at amounts in excess of what they would bring if sold. What answer would you give?

3. Give the order of procedure and describe tersely in enumerated paragraphs the steps required when called upon to adjust an incorrect trial balance with which the bookkeeper cannot agree. (C. P. A.)
3a. What scientific basis can you advance for the rule that "inventories should be valued at cost or market, whichever is lower"?
4. What is the function of the balance sheet? (C. P. A.)
4a. When, if ever, would it be desirable to value inventories of merchandise at selling values for balance sheet purposes?
5. What do you regard as the proper method of presenting a "balance sheet"; that is, as to form and as to arrangement of the items thereon? (C. P. A.)
5a. A corporation has among its notes receivable, a note given for stock subscriptions; also, a note given by an officer of the company to cover an overdraft on his salary account. The notes payable include a note in favor of another officer for money advanced to the business. How would you show these items in the balance sheet? Give reasons.
6. Prepare a specimen form of balance sheet for a $5,000,000 manufacturing or public service corporation, which will clearly set forth the financial condition of the concern. (C. P. A.)
7. Prepare a specimen form of profit and loss statement for the same corporation.
8. What is the mechanism of the double form balance sheet? Explain the connection between its sections, stating the theory of the organism. (C. P. A.)
8a. How should the following items be shown in a balance sheet?
   (a) Reserve for bad and doubtful accounts
   (b) Bills or notes receivable discounted
   (c) Accrued wages and taxes
   (d) Inventory reserve
   (e) Deficiency account (representing operation losses)

9. (a) Define contingent liability
   (b) Name three examples
   (c) State how they should be shown on the balance sheet (C. P. A.)
9a. How should the following items be shown in a balance sheet?
   (a) This company guarantees to furnish the steel necessary for the construction of a plant by another company, the steel to cost about $10,000.
   (b) An employee of the company is suing the company for $10,000 on account of injuries sustained while in its employ. The company's councilors advise that in their opinion a settlement can be made with the employee for $5,000.
10. A title insurance company collects its fees for searches and insurance, on signing the contracts with clients. The work to be done may extend over several months. Suggest a method of recording whereby the income may be spread over the period in which the expense is incurred. (C. P. A.)
10a. What criticism do you offer to the practice of a certain company of showing upon its balance sheet its mortgage payable deducted from the asset account of real estate?
11. You are employed to audit the balance sheet of a company which does all its business by contract. It takes from six months to three years to complete their contracts. In the assets in the balance sheet of the company at the date of your audit you find "uncompleted contracts." Should this item be taken into consideration in arriving at the profits of the business, and, if so, in what manner? (C. P. A.)
11a. At the close of each year, a certain company classifies all its uncol-

lected customers' accounts as between good, doubtful, and bad. What would be the purpose of doing this?

12. Illustrate prepaid accounts and accrual accounts used by concerns making monthly showings of operations. (C. P. A.)

12a. How should the following items be shown in a balance sheet as of December 31, 19—:
   (a) 1st Mortgage 7% Bonds in the amount of $100,000, given as collateral for a bank loan of $50,000.
   (b) $5,000 of a total amount of $70,000 of accounts receivable are in dispute.

13. How does a trading account differ from a profit and loss account? (C. P. A.)

13a. In summarizing the profit and loss accounts of a manufacturing concern at the close of a year in order to ascertain the operating results for the period,
   (a) What three closing accounts are necessary, and what elements enter into each of them?
   (b) State reasons for answer.

14. Why should indebtedness to employees and indebtedness to other creditors be shown separately on financial statements? Give reasons. (C. P. A.)

14a. After a patent has been obtained, should its value be considered as permanent? Give reasons.

15. What do you understand by comparative statistics as applied to accounting? When, to what extent and in what particulars would you make use of your knowledge of this branch of commercial science?

15a. In what respect and for what purpose could comparative statistics or percentages be made use of as regards the following:
   (a) Gross profit
   (b) Wages
   (c) Inventory of merchandise
   (d) Merchandise consumed
   (e) Costs of selling
   (f) Detection of fraud (C. P. A.)

Problem 1

From the following trial balance of Maker and Seller's books, extracted on December 31, covering six months' operations, prepare a manufacturing, trading and profit and loss account, and balance sheet:

	Dr.	*Cr.*
Cash at bank	$ 3,000.00	
Petty cash in hand	15.00	
Bills receivable on hand	1,000.00	
Sundry debtors	36,825.00	
Buildings	20,000.00	
Plant and machinery	15,000.00	
Sundry creditors		$ 9,850.00
Loan on mortgage		22,500.00
Material on hand, July 1 (raw material)	13,705.00	
Purchases	42,000.00	
Wages	7,020.00	
Discounts allowed on purchases		1,950.00
Discount allowed customers	4,690.00	
Returns (customers' returns for half year)	1,650.00	
Sales		80,000.00

Patent rights (expenses)	$ 250.00	
Rent and taxes	500.00	
Advertising	2,300.00	
Traveler's salary	2,150.00	
Carriage, outward	1,950.00	
Bad debts written off	500.00	
Repairs	420.00	
Patent royalties received in advance		$ 2,500.00
Royalties on patents attributed to half-year		200.00
Trade and general expenses	2,510.00	
Interest on loans	600.00	
Reserve for bad and doubtful debts		2,700.00
Reserve for discounts on book debts		985.00
Maker capital account		30,000.00
Maker drawing account	6,000.00	
Seller capital account		15,000.00
Seller drawing account	3,600.00	
	$165,685.00	$165,685.00

The goods on hand (raw material) on December 31, are valued at $17,500.00.

Write off 5% from plant and machinery for depreciation for the half year. The profits are to be apportioned as follows:

Maker	two-thirds
Seller	one-third

(C. P. A.)

Problem 2

Vincent Manufacturing Company
Trial Balance, December 31, 1906

Discounts, trade	$ 4,030	
Entertainment of customers	2,000	
Machinery inventory, Dec. 31, 1906	40,000	
Tools inventory, December 31, 1906	8,500	
Patents inventory, Dec. 31, 1906	21,000	
Patterns inventory, Dec. 31, 1906	12,400	
Merchandise consumed	410,000	
Bills receivable	3,050	
Accounts receivable	250,000	
Insurance:		
Machinery, tools and patterns	500	
Merchandise	650	
Employer's liability premiums	4,000	
Taxes, personal property	1,000	
Interest, general	4,470	
Cash	45,000	
Labor, productive	300,000	
Labor, unproductive	35,000	
Power	21,000	
Repairs, machinery	1,310	
Factory expenses	3,010	
Office pay roll	18,000	
Inventory, Jan. 1, 1906	75,000	
Merchandise sales		$1,048,500
Allowances	10,900	

Office furniture and fixtures	$ 5,700	
Salaries, officers	15,000	
Postage	2,000	
Telegrams and telephones	1,800	
Collection and exchange	700	
Stationery and printing	3,050	
Freight in	23,000	
Freight out	10,000	
Cartage and express in	3,750	
Bonding of employees (office)	250	
Traveling expense (salesmen)	17,500	
Salesmen's commission and salaries	40,000	
Bills payable		$ 99,505
Accounts payable		43,000
Surplus		43,520
Capital stock		200,000
Directors' fees	1,500	
Cartage out	4,300	
Discounts, trade		6,300
Return sales account	41,000	
	$1,440,370	$1,440,370

Inventory, Dec. 31, 1906, $90,000.

Prepare a statement of profit and loss and income, showing
- (a) Cost of manufacturing
- (b) Cost of selling
- (c) Cost of administration
- (d) Net profit
- (e) Surplus

(C. P. A.)

Problem 3

From the following trial balance and the additional facts, prepare whatever statements and schedules you deem necessary under the circumstances to present a clear-cut solution bringing out all the facts required.

Trial Balance, December 31, 1920

Cash	$11,320.21	
Accounts receivable	2,559.94	
Notes receivable	1,317.72	
Merchandise	3,342.80	
Consigned goods out	2,776.10	
Furniture and fixtures	207.90	
Building	1,125.00	
Land	6,000.00	
Accounts Payable		$ 4,686.37
Notes payable		2,742.27
N. Roe, capital		10,452.74
L. Doe, capital		10,340.24
Consignment proceeds		821.37
Purchase discounts		217.21
Interest income		107.01
Expenses	549.62	
Sales discount	133.77	
Interest expense	34.15	
	$29,367.21	$29,367.21

A fire occurred on the evening of December 24, which destroyed considerable property, including:

All the merchandise except what was sold in damaged condition for the sum of $1,500

The building

The furniture and fixtures

An analysis of the merchandise account produced the following:

Inventory, December 1, $3,372.55

Purchases for December, $14,152.39

Freight and cartage, $377.32

Sales to time of fire, $10,059.46

Damaged goods sold, $1,500

Insurance received on account of stock loss, $3,000

Cost of goods out on consignment, $2,745.50

An analysis of the building account shows the following:

Cost of building, $6,125

Insurance received on account of building loss, $5,000

An analysis of the capital accounts produced the following:

N. Roe:

Net balance brought down from November, $10,240.24

Salary credited thereto, $125

Traveling expenses credited thereto, having been paid out of pocket, $87.50

L. Doe:

Net balance brought down from November, $10,240.24

Salary credited thereto, $100

CHAPTER VIII

Questions and Problems

1. (a) Define a partnership.
   (b) State how it is formed.
   (c) How terminated. (C. P. A.)
2. What advantages has a partnership over a sole proprietorship? What are some of the characteristics of a partnership?
3. Distinguish between the working organization of a partnership and its legal organization.
4. Classify partnerships; partners.
5. Distinguish between a limited partnership and a joint stock company.
6. What is the authority of a partner as an agent of the firm? (C. P. A.)
7. What is the extent of a partner's liability to firm creditors? (C. P. A.)
8. Why is it advisable to have a written partnership agreement? Explain fully.
9. What are the tests by which it may be determined whether the parties have entered into a partnership? (C. P. A.)
10. Briefly express the important clauses that you, as an auditor, would expect to find in a partnership agreement. (C. P. A.)
11. What is the rule when a partnership agreement is silent as to the basis of profit and loss distribution?
12. How are disputes among partners settled? (C. P. A.)
13. How should credit balances appearing in a partner's drawing account and salary account be reflected on the balance sheet of the partnership? (C. P. A.)

14. A partner contributes accounts receivable to a firm as his share of the capital thereof. It is agreed that his Capital account is to be credited with 90% of the face value of these accounts. However, the amount realized thereon is only 85%. Give pro forma entries to record the above conditions.
15. A and B agree to enter into partnership on January 1, 19—. Each brings $1,700 in cash into the business. It is agreed that certain inheritable porperty belonging to A will be taken over at a valuation of $7,500. B brings into the partnership merchandise worth $1,900, and accounts receivable valued at $5,400. Prepare a balance sheet of the new firm as on January 1.

Problem 1

Smith admits King as an equal partner in his business. The following statement shows the condition of the business of Smith.

Cash on hand, $750; merchandise, $4,780; furniture and fixtures, $220; accounts receivable, $2,325; accounts payable, $1,136; notes receivable, $896; discount allowed on notes receivable, $6.84; Notes payable, $612; interest accrued on notes payable, $5.08; rent due and unpaid, $65; 5% of the accounts receivable are not collectible; unpaid freight, $22.45; goodwill of the business is estimated at $1,000.

King purchases a half interest in the business, giving Smith his note, indorsed by Bryan, for $1,500, for one year, with interest at 5%, and cash for the balance.

Present a balance sheet of the new firm.

Problem 2

On July 1, 1919, H. Durand, a manufacturer, entered into a partnership agreement with W. Smalls, his bookkeeper, and L. Hogan, which provided as follows:

W. Smalls is to invest cash sufficient to give him a total investment of $12,000, and L. Hogan $23,000. Of this investment H. Durand is to receive in lieu of goodwill, $2,500 in cash, and $2,500 in a three months' note, payable by the firm. The amount paid to H. Durand for his goodwill is to be charged $2,000 against W. Smalls, and $3,000 against L. Hogan.

A yearly salary is to be allowed each of the partners as follows: H. Durand, $2,000; W. Smalls, $1,500; L. Hogan, $1,500.

Interest at 5% per annum is to be allowed on the capital invested, and both interest and partners' salaries are to be charged against profits before net profits are allocated.

Profits and losses are to be shared as follows: H. Durand, 45%; W. Smalls, 15%; L. Hogan, 40%.

A reserve of $500 is to be set aside for possible losses on outstanding accounts receivable transferred by H. Durand.

The balance sheet of H. Durand on July 1, 1919, is as follows:

Assets

Cash on hand and in bank	$ 8,000	
Notes receivable	12,000	
Accounts receivable	22,000	
Inventories:		
Raw materials	1,000	
Goods in process	1,500	
Finished goods	3,500	
Supplies	500	
		$48,500

Machinery	$ 6,000	
Tools	800	
Fixtures and equipment	1,200	
Office furniture	400	
		8,400
Unexpired insurance		100
		$57,000

Liabilities and Capital

Notes payable	$ 9,000	
Accounts payable	18,000	
		$27,000
Accrued labor		500
Proprietorship:		
H. Durand		29,350
W. Smalls (percentage of profit)		150
		$57,000

Required:

Formulate opening entries for the partnership books as of July 1, 1919.

Problem 3

Roberts and Williams, partners, had been general traders for a number of years. Their books were made up on December 31, of a certain year, with a view to taking in their foreman, Peters, from January 2. The balance sheet of the firm on December 31, was as follows:

Land and buildings	$ 2,000	
Fixtures and fittings	400	
Stock on hand	3,000	
Debtors	1,800	
Bank	2,000	
Creditors		$ 1,200
Roberts, capital		6,000
Williams, capital		2,000
	$ 9,200	$ 9,200

Peters brought in as his capital the sum of $1,000; the profits were to be divided in the proportion of 6/9 to Roberts, 2/9 to Williams, and 1/9 to Peters. The partners were to draw as against profits, on the first of each month, the respective sums of $100, $33.33, and $16.67.

On December 31, of the new year, the books were made up, and the bookkeeper presented to the partners the following as the trial balance:

Land and buildings	$ 2,300	
Fixtures and fittings	400	
Stock	3,000	
Debtors	3,600	
Creditors		$ 1,100
Bank	800	
Purchases	5,000	
Rent, taxes, and insurance	400	
Freight and carriage	70	
Salaries and wages	430	
Coal, gas and lighting	40	

Printing, stationery and advertising	$ 60	
General office expenses	50	
Discount and commission	150	
Roberts, drawings	1,200	
Williams, drawings	400	
Peters, drawings	200	
Sales		$ 8,000
Roberts, capital		6,000
Williams, capital		2,000
Peters, capital		1,000
	$18,100	$18,100

The stock was taken by the foreman and partners jointly and amounted to the sum of $2,100.

Prepare:

(a) Profit and loss account, apportioning the profit or loss to the respective partners

(b) Make out a balance sheet

CHAPTER IX

Questions and Problems

1. A and B, partners, have a written partnership agreement as a basis of their firm relationship. After they have operated in accord therewith for a period of six months, they agree to waive a certain provision thereof. May this be done? Why?
2. State and explain the various relations which a partner may have toward the partnership at one and the same time.
3. What different methods are there of handling ledger accounts kept with partners?
4. A, B and C, in forming a partnership, agree that 5% interest shall be allowed on capital contributions. Give pro forma entry covering such condition at the close of an accounting period. In case of a net loss for the period, would your entry be different? Explain.
5. Under what condition should a salary account be kept with each partner? How should the balance of this account, when representing an underdraft or overdraft of the account, be shown on the balance sheet?
6. When would you close the balance in a partner's drawing account into his capital account, and when would you carry the balance forward into the next period?
7. At any specific moment of time, what determines the interest of a partner in a partnership?
8. On the transfer of a sole trader's business to a partnership, what necessary steps must be taken with regard to:
    1. The sole trader's accounts
    2. The partnership accounts
9. Define goodwill. (C. P. A.)
10. How should goodwill be treated in the accounts? (C. P. A.)
11. What is the liability of incoming partners? (C. P. A.)
12. What distinction would you make between an interest in a business and an interest in the profits of a business?
13. What should be done regarding the books on the admission of a new

partner to the firm? What entry should be made (a) when cash is invested for a certain share in the gains and losses, (b) when a specified amount is paid to the old members for a certain share in the gains and losses? (C. P. A.)

14. A firm is composed of two partners, A and B, whose capital accounts show credit balances of $30,000 and $50,000, respectively. How much must C invest to give him a 1/5 interest?
15. M is in business, his capital being $1,130.02. He takes S into partnership upon the following conditions: S is to put $1,000 into the business, and give M $500, for a one-half interest therein. Adjust the capital accounts to meet this condition.

Problem 1

Arnold and Jenkins, operating separately, decide to enter into partnership on July 1, 1915. Their respective balance sheets as of that date were as follows:

ARNOLD

Assets	
Furniture and Fixtures	$ 2,250.00
Accounts Receivable	7,500.00
Merchandise	7,650.00
Cash	600.00
	$18,000.00

Liabilities	
Accounts Payable	$ 3,000.00
Capital Account	15,000.00
	$18,000.00

JENKINS

Assets	
Furniture and Fixtures	$ 1,800.00
Accounts Receivable	4,500.00
Merchandise	6,000.00
Cash	1,200.00
	$13,500.00

Liabilities	
Accounts Payable	$ 4,500.00
Capital Account	9,000.00
	$13,500.00

It was agreed that Arnold & Jenkins should put in their accounts receivable at 10% less than face value, these amounts to be charged against their capital accounts and carried on the partnership books as a reserve for bad debts. Of Jenkins' furniture only $750 was to be taken over by the partnership. With the above exceptions, the assets and liabilities of the parties were to be taken over by the partnership at above figures, except that Jenkins was to invest in the partnership, in cash, an amount which, after making the adjustments above referred to, would make his capital account the same as that of Arnold.

You are asked to draw off a balance sheet of Arnold & Jenkins' partnership July 1, 1915, showing effect of above provisions. (C. P. A.)

PROBLEM 2

A firm is composed of X and Y whose capital accounts show $10,000 and $14,000, respectively, profits being shared equally. Show entries for the admission of Z as a partner under each of the following conditions:

(a) Z offers to buy a one-third interest in the business from X and Y for $15,000

(b) Z offers to contribute such a sum as will give him a one-third interest in the partnership

Assume in each case, that the interests of the three partners are to be adjusted so that they will be equal.

PROBLEM 3

A and B partners in a commercial enterprise, share profits and losses equally. At the end of five years the partnership terminates and the balance sheet shows as follows:

Assets		Liabilities		
Cash on hand and in bank...	$ 5,600	Accounts payable..........		$30,000
Accounts receivable.........	28,000	Bills payable..............		10,000
Mdse inventory	36,000			
Plant and machinery.......	15,400	Capital:		45,000
		A	$30,000	
		B	15,000	
	$85,000			$85,000

After studying the balance sheet an offer to buy at $30,000 (except cash) is accepted. Make final adjustments and closing entries and show amount each partner receives. (C. P. A.)

CHAPTER X

QUESTIONS AND PROBLEMS

1. Enumerate the elements of business profits in a partnership.
2. In the case of a partnership how would you dispose of the balance of the profit and loss account? (C. P. A.)
3. Enumerate the order in which the entries necessary to close the books of a partnership usually are made. Present pro forma journal entries to cover such closing.
4. Enumerate the different methods of distributing profits and losses in a partnership.
5. Give a rule for adjusting partners' accounts (a) when the gains or losses are to be divided in proportion to each partner's investment and the time it remains in use, (b) when the proportion of gain or loss is fixed and interest is calculated on excess or deficit of capital. (C. P. A.)
6. What is the object of crediting partners in a firm with interest on their capital before ascertaining the profits divisible between them?
7. (a) If the capital accounts of two partners are unequal, profits being shared equally, which partner would lose?

(b) If the capital accounts of two partners are equal, profits being shared unequally, which partner loses if interest is not allowed on the capital invested?

(c) Under what conditions would neither partner gain or lose if interest is not calculated on capital?

8. What method should be pursued in adjusting interest on capital among partners whose investments differ in amount? Give reasons for such book entries as you would recommend in the premises. (C. P. A.)

9. Under what conditions may interest on partners' capital invested in a firm be charged and credited to the partners' accounts in the absence of an agreement to that effect under the terms of a partnership? (C. P. A.)

10. Brown and Jones are partners sharing profits and losses equally. Interest is to be allowed on partners' capital at the rate of 6% per annum. Brown invested $50,000 and Jones invested $30,000. During the first year, the firm suffered a loss of $2,600. What entries should be made under these circumstances?

11. Smith and Edwards conduct a business as partners under a partnership agreement that is silent on the point of charging interest on partners' drawings, but which specifies that interest at the rate of 5% per annum shall be allowed on partners' capital. Should interest be charged upon the drawings? Why?

12. (a) In a certain firm, interest is allowed on partners' capital. Is this a proper charge against earnings?

(b) Would interest charged on partners' withdrawals be a proper credit to earnings?

13. A partnership contract between A and B provides that each partner shall contribute $25,000 to a new business, and that on any capital brought in by either partner in excess of this amount he shall receive 6%. A contributes $10,000 additional and the bookkeeper makes an entry in the books at the end of the year crediting A with 6% on $10,000; viz., $600, which is debited to B. Is this correct? Give reasons. (C. P. A.)

14. A and B formed a partnership. During the continuance of same, B at various times loaned to the copartnership large sums of money, but there was no express agreement by the firm to pay interest. Is B entitled to interest on the loans? If so, why? If not, why not? (C. P. A.)

15. (a) If a partnership insures the life of a partner for the benefit of the firm, what entry would be made for the annual premium?

(b) At what valuation would you show the policy among the firm assets?

(c) In the event of death, what distribution of the insurance should be made?

Problem 1

A, B and C agree to start in business with a capital of $200,000, of which A is to furnish $100,000, and B and C, each $50,000. A is to have ½ interest in the business and B and C, each ¼. Interest at 5% is to be credited on excess, or charged on deficiency of capital. A contributes $100,000, B $45,000, and C $40,000. How would the capital accounts stand on the books after adjusting the interest at the end of the year?

Problem 2

Bailey and Hobbs were partners sharing profits and losses equally. On January 1, 1919, Bailey, without the knowledge or consent of Hobbs, pur-

chased 40 shares of the Cheatem Mining Company for $4,000. Brokerage expenses on the purchase amounted to $50. On December 31, 1920, when the partnership terminated, an audit of the firm books showed these shares to be worthless. Hobbs, after reading the report of the audit, objected to the action of his partner, and the matter was referred to an attorney for arbitration. The arbitrator decided that Bailey had exceeded his authority in making the investment. On January 1, 1920, the Cheatem Mining Company declared a dividend of 5%, this being credited to the firm's accounts.

Prepare the entries necessary to bring the partners' accounts into agreement with the award of the arbitrator at December 31, 1920. Interest at 6% is to be allowed on the partners' accounts.

PROBLEM 3

A, B, C and D are partners. On January 1, 1917, their capital accounts showed balances as follows:

A	$7,500.00
B	4,000.00
C	6,200.00
D	6,800.00

The net profit or loss for 1917, 1918, and 1919, was as follows:

1917	$ 600.00, loss
1918	6,000.00, profit
1919	9,000.00, profit

Drawings by the partners during 1917, 1918, and 1919, were:

1917	A,	$1,250.00
	B,	800.00
	C,	900.00
	D,	1,000.00
1918	A,	1,300.00
	B,	600.00
	C,	950.00
	D,	1,550.00
1919	A,	1,150.00
	B,	650.00
	C,	1,050.00
	D,	1,200.00

Interest is credited on capital at 5% per annum; no interest to be charged on drawings.

Construct the capital accounts of each partner.

CHAPTER XI

QUESTIONS AND PROBLEMS

1. Define from the viewpoint of partnership accounting:
   (a) Special partner
   (b) Capital contribution
   (c) Realized profit
   (d) Realization of assets account
   (e) Realization and liquidation account
2. How may a partnership be terminated?

3. Is there any difference in the rights of firm creditors as compared with those of the creditors of the separate partners? Explain. (C. P. A.)
4. Explain the doctrine of marshalling assets as applied to partnerships.
5. Is a surviving partner entitled to compensation on winding up the affairs of the firm? (C. P. A.)
6. On dissolution, through death, of a partnership, is the surviving partner, in absence of an express agreement, entitled to continue the business, or must he account for the goodwill of the business to the representatives of the deceased? (C. P. A.)
7. What is the function of the capital accounts in the management and dissolution of partnership activity?
8. A partnership consists of two members, A and B. A has a preponderance of capital in the partnership fund. What rights does such a condition give him?
9. As the bookkeeper of a firm that has no articles of partnership, what would be your duty on learning of the death of a partner? (C. P. A.)
10. In an old established business where the rule has been to charge against the profits, interest upon the capital investment of the partners and where the parties were arranging to dispose of their business upon the basis of average profits over a period of years, what would be your course of action were you called upon to submit a statement of profit and loss on their behalf?
11. On dissolution of a partnership, in what order should the assets be distributed when there are creditors of the firm and loans by partners of the firm, besides their stipulated capital in the business, and assuming that there is insufficient to repay the capital in full, profits being divided in a different ratio from capital?
12. In case of liquidation, what is the status of a loan or advance made to a firm by a partner?
13. Explain the procedure by which the cash received during the process of realization and liquidation of a partnership may be paid to the partners in installments without any one partner being overpaid.
14. A and B are partners, A having an investment of $5,000 and B an investment of $10,000. There is no agreement as to sharing profits and losses. The firm dissolved, creditors were paid, and $8,000 then remained in cash which was to be divided between the partners.

    A contends that since no agreement existed as to the sharing of profits, the $8,000 should be divided equally.

    B contends the $8,000 should be divided in proportion to the capital accounts, A $\frac{1}{3}$, and B $\frac{2}{3}$.

    Which partner is correct?
15. If interest on a partner's loan is not paid in cash, to what account should it be credited?

Problem 1

A, B, and C are in partnership. A invested $11,000; B invested $5,000; and C invested $1,200. Their agreement provides that profits or losses shall be divided as follows:

A $\frac{4}{9}$
B $\frac{3}{9}$
C $\frac{2}{9}$

The partnership has become insolvent and has therefore decided to dissolve. The cash value of assets is $10,000. The deficit is, therefore, $7,200. How should the assets be divided and how much money will each partner receive? (C. P. A.)

PROBLEM 2

A and B agree to dissolve partnership December 31, 1908. On that date the stated balance sheet was as follows:

Assets		
Merchandise Inventory	$ 57,500	
Furniture and Fixtures	2,000	
Accounts Receivable	85,500	
Bills Receivable (discounted)	14,000	
Goodwill	5,000	
		$164,000
Liabilities		
Accounts Payable	$ 50,000	
Bank	2,500	
Bills Payable	11,500	
Bills Receivable (discounted)	14,000	
A, Capital	53,500	
B, Capital	17,500	
Income Account	15,000	
		$164,000

Profits are divisible, A 4/7, and B 3/7, five per cent. being allowed on capital, and no interest charged on drawings, which were upon the basis of $2,500 each. A continues the business and assumes all liabilities. B, opening up business elsewhere, takes ¼ of the stock and agrees to leave in the business $2,500 as a guarantee for one year against floating liability for bad debts and discounted merchandise notes, and to receive or pay any balance in cash, any amount received being derived from accounts due the firm.

Prepare A's balance sheet after dissolution expressive of the terms stated.

PROBLEM 3

Bilsom and Marley are partners, sharing profits and losses equally. The partnership is dissolved December 31, 1907, at which time Bilsom's capital investment is $10,000, and Marley's $2,500. The total liabilities of the firm are $25,000, which includes $5,000 due Bilsom on loan account and $2,500 due Marley on loan account. The whole of the assets of the firm are disposed of for $30,000 cash on May 1, 1908. Prepare accounts closing the partnership and show the position in which the partners stand with each other. No allowance for interest is required. (C. P. A.)

CHAPTER XII

QUESTIONS AND PROBLEMS

1. A large company has several branch offices in each of which a separate set of books is kept; each of such branch records is controlled by proper accounts upon the books of the home office. At the end of the year, when the home office balance sheet is prepared, the net balance in each branch controlling account is included therein under the general heading of "accounts receivable." Is this method correct? If so, why? If not, why not?
2. Goods are shipped from a factory to a branch store. How should the invoice be made out in order that the proper results of the business may be shown in the books at the factory? (C. P. A.)

3. What results are sought to be secured in the keeping of accounts with branch houses? Under what circumstances would you debit or credit such accounts? What would the balance of any such account show? (C. P. A.)
4. The Jones Dress Company sent goods costing $40,000 to one of its branches; this amount was charged to the branch at cost. The branch sold these goods for $60,000, of which amount $50,000 was cash sales and $10,000 charge sales; the sales were credited to the branch. At the end of the year, the home office charged the branch account with the gross profit. The branch has no cash fund out of which it pays expenses. In all, the branch paid out for expenses $900 from the receipts from cash sales before remitting the cash to the home office. No accounts are collected by the branch. Make the necessary entries on the home office books to cover the above transactions.
5. A firm having several branches maintains an account with each branch in the ledger and charges to such account all goods sent to the agents for stock. When stock is taken the balance of each branch account is treated as ordinary accounts receivable and is included in the general debts owing to the firm. If you see any objections to this method, state them, and say how you would deal with the accounts. (C. P. A.)
6. Should a manufacturing establishment invoice its sales to its branch houses at cost or at a profit? What would be the advantages or disadvantages for either the factory or the branches by either of these methods? Explain. (C. P. A.)
7. On the morning of December 31, 1919, the home office of a certain concern located in New York mails $10,000 to its branch located in Louisville, Ky., and telegraphs the branch to that effect. How should this item be handled by the branch so that its account with the home office will be in agreement with the home office account with its branch on the trial balance as of December 31, 1919?
8. What method would you recommend for recording the cash receipts on the general cash book of a company operating 10 branch houses, each depositing its daily receipts in a separate bank? (C. P. A.)
9. It is found in an audit that certain merchandise shipped to an agent for sale has been charged to his personal account and credited to the sales account. Make correcting entries, if any.
10. What basic principles should guide one in devising an accounting system for a large mercantile establishment?
11. Under what condition would a revenue expenditure appear in a balance sheet as an asset? (C. P. A.)
12. Explain four different uses of the word "discount" used in accounting. (C. P. A.)
13. (a) State the advantages of controlling accounts.
    (b) What are some of the advantages of using additional columns in the cash book and journal?
14. What is an income and expenditure account and wherein does it differ from an account of receipts and payments?
15. What is meant by a voucher record? What are the advantages and disadvantages of the voucher system?

Problem 1

A branch office was started the first of the year. the head office advancing $5,000.00 cash. During the first year merchandise was shipped to branch, invoiced at $75,000.00.

An auditor checking up the business at the close of the year, finds the following:

Merchandise sales were $60,000.00, with selling price of goods 20% advance on invoice.

Proper vouchers were on file duly receipted for following payments:

Rebates and allowances on damaged goods	$1,500.00
Salaries and other expenses	4,500.00
Freights	2,500.00

The books also showed:

Remittances to head office	35,000.00
Uncollected accounts	15,000.00

the balance of sales having been realized in cash, less rebates and allowances as noted.

The cash on hand and inventory of unsold goods, together with the foregoing records, properly account for everything.

Prepare statement, such as an auditor would make in reporting to the head office, balancing the business of the branch house. (C. P. A.)

Problem 2

A manufacturing concern having a branch in another town presents the following trial balances on January 1, 1912:

Main Office

Plant	$125,500	Capital stock	$250,000
Material and supplies, (inventory Jan. 1, 1911)	68,300	Notes payable	30,000
Purchases	245,800	Accounts payable	42,630
Labor	163,400	Net sales	480,300
General expense	24,900	Profit and loss (Jan. 1, 1911)	31,820
Insurance—(1 yr. to Jan. 1, 1912)	3,400		
Accounts receivable, (worth 95%)	84,600		
Cash	4,870		
Dividends paid	20,000		
Branch	93,980		
	$834,750		$834,750

Branch

Plant	$ 35,200	Net sales	$ 97,620
Material and supplies, (inventory Jan. 1, 1911)	16,500	Main office	93,980
Purchases	62,450		
Labor	40,610		
Insurance (1 yr. to April 1, 1912)	1,260		
General expense	7,820		
Accounts receivable (worth 100%)	24,600		
Cash	3,160		
	$191,600		$191,600

Inventories of material and supplies on January 1, 1912, were: Main office, $45,300; branch, $28,400.

No inventories of finished goods, as same were sold on contract for daily shipments, and are all billed up on closing.

In closing on January 1, 1911, the branch charged off all insurance.

General expense includes salaries, office expense, taxes, etc.

Selling expense has been deducted from the sales.

Construct one working account profit and loss account and closing balance sheet for the entire concern, omitting estimate for depreciation. (C. P. A.)

Problem 3

The Keystone Manufacturing Company opened a branch store on January 1, 1918, and installed Jones therein as manager. From that date to December 31, 1919, the following transactions took place:

1. Merchandise to the value of $13,601.33 was shipped during the year direct from the warehouse of the factory.
2. Freight charges on this shipment were prepaid by the home office and amounted to $1,010.17.
3. Uncollected customers' accounts at December 31, 1919, amounted to $4,644.75.
4. Salaries and other expenses unpaid as on December 31, 1919, were $608.94.
5. The branch bought and paid for direct merchandise in the amount of $9,112.88.
6. The total sales of all kinds for the year ended December 31, 1919 amounted to $38,566.77.
7. Branch expenses paid during the year, exclusive of the unpaid items already mentioned above (rent, advertising, salaries, etc.) were $7,444.13.
8. Management expenses and salaries of the home office in the amount of $700.00 were prorated against the branch office.
9. Merchandise was shipped to branch No. 2, in the amount of $1,414.66 (inclusive of freight charges thereon of $101.11).
10. Inventory of merchandise on hand December 31, 1919, was $1,209.73.

The branch keeps a separate set of books.

Required:

1. Entries necessary to record the above transactions in the books of both the branch and the home office.
2. Closing entries for the branch books; take up the profit or loss thereby shown, on the home office books.
3. Statements necessary to show the profits or losses from trading and a summary of the transactions between the branch and the home office.

CHAPTER XIII

Questions and Problems

1. Define the following accounts:
   - (a) Shipment
   - (b) Suspense
   - (c) Trading
   - (d) Consignment
   - (e) Construction

2. What is the difference between a sale and a consignment? (C. P. A.)
3. Give the difference between a customer's account and a consignment account, and state how each should be classified in a general balance sheet. (C. P. A.)
4. How would you record a consignment in the books of
   (a) The consignor
   (b) The consignee (C. P. A.)
5. State two ways of treating consignments inward, when goods are to be sold subject to commission, at the price at which they are consigned. Give the arguments for and against each method and your views thereon. (C. P. A.)
6. Describe a set of books for a commission merchant. Show the relation of each book to the other books of the set. (C. P. A.)
7. In what respects and for what reason do the books of account of a commission merchant differ from those kept by an importer? (C. P. A.)
8. In the business of a factor what does the balance of sales account represent? Why? (C. P. A.)
9. How should a consignment account be stated in a balance sheet? (C. P. A.)
10. Included among the accounts receivable of a certain business is the following:

    Consignment stocks....................$90,000.00

    Do you consider this item to have been properly classified? Give reasons.
11. In closing books how would you value the goods owned by your client and consigned at selling prices to customers of your client, under an agreement by which the customers pay for the goods as used? Give reasons. (C. P. A.)
12. A concern markets its own products, except a small percentage which is sold and billed to agents, less commission allowed them. In making statements of the business, should such commission be deducted in showing gross sales for a period, or should it be stated as a trading expense, all sales being stated at regular market prices?
13. How may the profit or loss be ascertained from a set of single entry records?
14. Compare briefly and concisely the underlying principles of double entry with those of single entry.
15. Distinguish clearly between capital expenditures and revenue expenditures, illustrating each.

Problem 1

Alfred and Company of New York consign goods valued at cost $3,500 to Brown and Company of London, on January 1. Brown and Company duly acknowledge receipt, but report that goods to the value of $500 have been damaged in transit and are unsalable. Brown and Company send an account sale June 5, of a part of the consignment which has realized $2,250, and on June 30 render a further account sale of the balance which realized $1,850, and they remit Alfred and Company $3,790 in full settlement after all expense and commission are deducted. Show how these transactions would appear in Alfred and Company's books and what profits, if any, they would make on the transaction.

Problem 2

The trial balance of the Heavy Pile Fabric Company (general ledger) as of December 31, 1919, contains the following item:

Accounts Receivable, Consignment................$13,547.07

An abstract of the consignment ledger balances, as of the same date, is as follows:

S. L. & Co., Inventory Account........	$25,739.06	
S. L. & Co., Finance Account..........		$10,197.87
J. T. & Co., Inventory Account........	483.89	
J. T. & Co., Finance Account..........	1,624.84	
D. K. & Co., Inventory Account.......		5,394.84
D. K. & Co., Finance Account..........	1,101.71	
G. M. & Co., Inventory Account.......	190.28	
	$29,139.78	$15,592.71

The inventories of goods out on consignment (from inventory record) were as follows:

S. L. & Co..........................	$18,664.09
J. T. & Co..........................	133.35
D. K. & Co..........................	4,603,65
G. M. & Co..........................	190.28

These inventory items, upon examination were found to be correct as to amounts. The inventory of goods at the mill was $32,086.26.

How will these various consignment transactions appear upon the balance sheet of the Heavy Pile Fabric Company, December 31, 1919?

Problem 3

John Ball, on January 1, 1919, commenced business as a factor without capital. His business was conducted in accord with the principles of del credere agency; he charged 10% commission and 5% guaranty. You are to prepare for him on December 31, 1919, a balance sheet with relative statement of profits and income.

His accounts present the following information: $2,000 borrowed upon a demand note, the note still unpaid and interest accumulated thereon in the amount of $120; $49,600 in cash remitted to a consignor; consignments received in the amount of $150,000, cost price; cash sales were $15,000 and other sales $60,000; merchandise on hand, at cost, in the amount of $100,000; he has accounted to his principals for $60,000 of the sales; commissions and guaranty charged to consignor $8,250; customers' open accounts, all good, due and payable, on December 31; claims and allowances allowed customers $1,500, and cash discounts $1,500, all of which is chargeable to the consignor, but of which, on December 31, only $1,200 and $800 respectively had been charged to the consignor; Infreight paid on consignments amounted to $400, of which amount $150 had been deducted in prior settlements with the consignor; the factor's own expenses were $750, paid in cash, exclusive of sundry other items of expense still unpaid amounting to $250; drawings were $3,000.

Required:

1. Journal entries for the above indicated facts.
2. Trial balance before closing.
3. Balance sheet as at December 31, 1919.
4. Statement of profits and income to accompany this balance sheet.
5. Final account sales establishing amount due to the consignor.

CHAPTER XIV

Questions and Problems

1. Define the following accounts:
   (a) Venture
   (b) Joint
   (c) Merchandise company
2. Define the term "account current."
3. Make out an account for Jones & Company covering the following transactions with Smith & Company:

June 1, 1919, Goods sold Smith & Co................$	500.00
July 1, 1919, Cash received from S. & Co...........	260.00
Aug. 15, 1919, Goods bought from S. & Co...........	1,310.00
Sept. 1, 1919, Cash paid to S. & Co................	900.00
Sept. 15, 1919, Cash paid to S. & Co................	810.00
Oct. 1, 1919, Goods bought from S. & Co............	1,415.00
Oct. 15, 1919, Goods bought from S. & Co...........	740.00

This account is to be prepared as of October 31, 1919, and interest is to be calculated thereon at 6%, per annum, 360 days to be considered a year.

4. Give a rule averaging the maturity of the balance of an account containing items of various dates on each side. (C. P. A.)
5. A, in current account with B, engages an accountant to prepare a statement, to be mailed to B from the following facts:
   Debits:

1914		
May 12........................$	750.00	
May 30........................	117.00	
June 12........................	340.00	
July 1........................	150.00	
		$1,357.00
Credits:		
1914		
June 10........................$	500.00	
June 30........................	300.00	
		800.00
Balance		$ 557.00

Find average due date of the account and interest at 5% to July 1, 365 days to the year. (C. P. A.)

6. From the following ledger account:
   1. Find average due date of the debits
   2. Find average due date of the credits
   3. Find average due date of the balance

Debits		Credits	
1915		1915	
Jan. 4......................	$1,000.00	July 16......................	$1,000.00
Jan. 20......................	200.00	Sept. 5	4,000.00
Feb. 2......................	500.00	Dec. 20	500.00
Feb. 3......................	100.00		
Apr. 16......................	100.00		

June 10	20.00
July 7....................	100.00
July 20..................	2,000.00
Aug. 14...................	400.00
Sept. 10	500.00
Nov. 25...................	100.00
Dec. 30	2,500.00

(C. P. A.)

7. Recommend, with all necessary explanations, a set of books peculiarly adapted to the use of a firm that deals exclusively in butter, cheese and eggs, at wholesale, retail, and on commission, and has three branches in the same city, the books being kept at the main store. (C. P. A.)
8. In the examination of a business you find that all past due accounts receivable are promptly charged to a suspense account and the suspense account is plainly stated on the balance sheet among the assets. Do you consider this satisfactory; or what form of account would you recommend should be set up to care for such items?
9. A fire in a manufacturing concern resulted in a loss on machinery, \$5,000; merchandise (raw material), \$10,000; manufactured goods, \$25,000; which amount of \$40,000 was agreed on and paid by the insurance companies. Give the entries necessary to record properly the above transactions on the books of the concern. (C. P. A.)
10. A company shows among its assets \$2,675 as unexpired insurance on January 1, 1907. On February 1, 1907, the plant is destroyed by fire and a total loss of \$57,875 occurs, which the insurance company pays. How would you treat the \$2,675 unexpired insurance? (C. P. A.)
11. In an inventory, how should goods bought on credit, subject to the usual discounts, be valued?
12. A and B, partners, have the following amounts credited to their capital accounts, representing investment:

A	\$15,967.00
B	4,301.00

On December 31, 19—, they ascertain that their profits for the year amount to \$7,610.25. How should these profits be distributed between them?

13. Explain how profits are divided, in a partnership. when the partnership agreement states that profits are to be divided in proportion to investments made and time such investments remain in the business.
14. The assets of an insolvent partnership are being distributed. One partner has made a loan of \$5,000 to the business. In what order would the assets of this partnership be distributed?
15. Would you, or would you not, advise carrying the value of land separate from the value of the buildings upon the land? Why?

Problem 1

In connection with your general merchandise business, you are a managing partner on a joint account, where your one-half of merchandise cost was \$15,000. Charges posted \$150; total sales \$8,000, and joint unsold merchandise \$13,500. Settlement charges were: Storage, \$60; commission. 5% on sales.

Prepare ledger account, and show journal entries closing the account on your books, you giving your partner, Robert Bailey, your note for his one-half of net proceeds.

Suppose your one-half first cost was \$10,000. Charges were \$9,000; sales \$4,500; storage, \$20; joint property unsold, \$2,100; commission, 5%.

Prepare ledger account and show journal entries closing the account on your books, charging Bailey with his share of the deficiency. (C. P. A.)

Problem 2

A, B and C agree to purchase and sell coffee for their joint account. They purchase 3,000 bags of coffee for $58,500 and one month thereafter sell the same at 16 cents per lb. (say 130 lbs. to the bag). The warehouse charges, labor, cartage, weighing, brokerage, etc., amount to $600.

A contributes cash....................			$20,000.00
B contributes note at 4 months		$19,000,00	
Discount at 6% on same...............		?	?
C contributes cash....................		$18,900.00	
C contributes note at 3 months.........	$ 2,500.00		
Discount at 6% on same...............	?	?	?
			$59,982.50

It was arranged that each should contribute equally to the requisite purchase money, in default of which, interest at 6% per annum for the month covering the transaction was to be calculated between them, to equalize their respective contributions.

Prepare an account of the venture; also separate accounts of A, B and C, showing the share of each in the final net proceeds. (C. P. A.)

Problem 3

A, B & Co., agree with C, D & Co., that the latter shall ship on consignment to Honolulu on joint account, 20 cases of commodity "X," the invoice price of which is $2,100, less 2½%. A, B & Co., pay the packing charges, $25; also freight, insurance, and other charges, $90, and they draw on their correspondents in Honolulu in advance for $1,600, at 90 days, which is discounted at a cost of $20, and the proceeds handed to C, D & Co., as part payment. These transactions may be dated March 31. On the 30th of November, A, B & Co., receive the account sales and net proceeds, $418, and they then pay C, D & Co., the balance due to them.

Prepare a joint consignment account, charging interest on the amount lying out at 5 per cent. per annum for eight months, closing it by dividing the loss. Also an account to be rendered by A, B & Co., to C, D & Co., closed by payment of the balance and prove that the losses borne by each are equal. (C. P. A.)

CHAPTER XV

Questions and Problems

1. Enumerate, for a manufacturing concern, some of the items entering into the cost of finished goods.
2. Distinguish between the elements composing the cost of goods sold in a trading concern as compared with the elements thereof in a manufacturing concern.
3. A certain manufacturer charges infreight direct to his material accounts. Criticize this practice.
4. A manufacturing firm imports its raw material and purchases exchange

on Europe in payment. How should the exchange account be treated with respect to the cost of production? (C. P. A.)

5. What constitutes manufacturing cost?
6. Distinguish between productive labor and non-productive labor.
6a. Sometimes the provision for depreciation is considered as a legitimate charge to the manufacturing account. What reasons can you mention to support this practice?
7. Name any three important accounts carried in the financial books of a manufacturing company which are directly connected with the control of a complete cost system, and briefly explain each account. (C. P. A.)
8. What are the essential differences between
   (a) A trading account
   (b) A profit and loss account
   (c) A manufacturing account (C. P. A.)
9. What are the constituent elements to be considered in fixing the selling price of a manufactured product? (C. P. A.)
9a. What is the object of setting up separate manufacturing, trading and profit and loss accounts?
10. The following facts are recorded in a merchandise account in A's ledger:

Sales	$45,000
Purchases	30,000
Freight and cartage (on sales $500, on purchases $500)	1,000
Returns by us	2,500
Cash discounts allowed customers	6,750
Cash discounts taken by A	750
Allowances to customers	1,000
Inventory at close of year	5,000
Profit on merchandise sales	14,500

Construct accounts from the above which will record the net amount of purchases, net amount of sales, and the inventory at close of period. Give and post journal entries for closing these three accounts in order to determine the profit on merchandise sales. (C. P. A.)

11. Prepare a manufacturing, a trading, and a profit and loss statement (without using figures), and include therein the following items:
   (a) Insurance of factory
   (b) Freight inward
   (c) Interest allowed on partners' capital
   (d) Salesmen's commissions
   (e) Labor in getting raw material from freight cars to warehouse
   (f) Cash discounts received from creditors
   (g) Royalties paid for use of patented process in manufacturing
   (h) Return sales
   (i) Rent of factory
   (j) Depreciation of office building
   (k) Cash discounts allowed to customers
   (l) Depreciation of machinery
   (m) Freight outward
   (n) Interest on capital borrowed to purchase machinery
   (o) Allowance to customers for damaged goods (C. P. A).
12. Purchase invoices are not entered upon a firm's books until they have matured. Criticize this method of handling invoices and indicate its effect upon the firm's balance sheet.
13. State three important methods of calculating depreciation, briefly explaining each. (C. P. A.)
14. Give rates of depreciation commonly used for the following classes of

property, stating the method of applying them; it being understood that ordinary repairs and maintenance are charged against earnings.
(a) Buildings, brick mill construction
(b) Machinery, large machinery such as is used in automobile manufacturing
(c) Steam boilers, stationary
(d) Office furniture

15. What plan would you suggest to minimize the risk of fraud in
(a) Payrolls
(b) Cash receipts (C. P. A.)

Problem 1

The following is a trial balance June 30, 1916, before closing, of the ledger of a textile mill:

Land	$ 10,000.00	
Buildings	75,000.00	
Machinery	119,138.73	
Tenements	1,670.66	
Finished Goods Inventory, January 1, 1916	66,984.43	
Stock in Process Inventory, January 1, 1916	57,042.38	
Yarn	259,882.12	
Cash	12,769.19	
Petty Cash	106.39	
Accounts Receivable	46,085.68	
Mortgage Receivable	875.00	
Labor	25,979.27	
Supplies	2,974.31	
Repairs	956.63	
Oils	50.84	
Coal	1,443.20	
Starch	1,390.00	
Water	122.65	
Finishing	15,381.54	
Brokerage	660.50	
Commission	4,580.67	
Discounts Allowed	1,246.84	
Insurance	679.92	
Taxes	1,502.81	
General Expense	389.39	
Freight and Express	974.34	
Telephone and Telegraph	68.72	
Traveling Expense	274.85	
Interest Paid	409.80	
Discount on Notes Payable	1,408.00	
Profit and Loss	20,694.80	
Dividends	3,375.00	
Capital Stock, Preferred 6% Cumulative		$100,000.00
Capital Stock, Common		263,800.00
Accounts Payable		40,864.56
Notes Payable		187,500.00
Cloth Sales		137,818.07
Waste Sales		922.94
Tenement Rents Received		339.50
Discounts Taken		2,873.59
	$734,118.66	$734,118.66

Inventories and Items, June 30, 1916:

Finished Goods	$104,190.24
Stock in Process	71,242.39
Yarn	135,661.63
Coal	1,000.00
Starch	900.00
Supplies	1,150.00
Interest Accrued on Notes Payable	389.41
Interest Prepaid on Notes Payable	211.11
Wages Accrued	2,051.05
Unexpired Insurance	600.00
Prepaid Taxes	402.26
Prepaid Water Rates	100.00
Bad Debts	100.00
Estimated Discounts to be taken on Accounts Payable...	817.29
Estimated Discounts to be allowed on Accounts Receivable	460.86

Depreciation rates per annum are 5% on machinery; 3% on tenements; 2% on mill buildings.

Depreciation for the period of six months ending December 31, 1915, was not put upon the books. No additions have been made to the fixed assets within a year.

Estimated discounts on the accounts receivable and payable were not put upon the books January 1, 1916; these were respectively $400 and $750.

The last two semi-annual dividends on preferred stock are unpaid.

Prepare proper statements for a report to the directors as of June 30, 1916. (C. P. A.)

Comments:

1. Tenements. This refers to tenement properties held for the housing of employees. Consider the investment therein as not affecting the manufacturing statement.

2. Waste sales. Assume same as representing sales of factory waste, and use amount as a reduction of manufacturing expense.

3. Dividends on preferred stock. The dividends on this stock are cumulative; i. e., if unpaid in any year, they must be paid for such year during subsequent years before dividends can be paid upon the common stock. Show the unpaid amount as a liability upon the balance sheet, on the assumption that they have been declared.

Problem 2

The records of the superintendent of a manufacturing plant show the following information:

Raw material consumed during year	$91,520.00
Inventory of material (raw) beginnning of year	7,500.00
Inventory of raw material in process beginning of year	2,400.00
Inventory of raw material end of year	9,000.00
Inventory of raw material in process end of year	2,880.00

Prepare a correct form of statement showing the value of raw material purchased and value of raw material put in process. (C. P. A.)

Problem 3

The Pacific Iron Company operates a factory for the manufacture of general iron work at a distance from the main office. All shipments are made from the factory and all bills for sales made issued by the main office.

No cost accounts have been kept in the past but they are now desirous of installing a proper cost system, including factory, work in process and

stores ledgers at the factory. You are handed the following trial balance of their books as of June 1, 1912, the beginning of their fiscal year, as a basis for opening new records.

Pacific Iron Company

Trial Balance as at June 1, 1912

Cash	$ 5,674.10	
Accounts receivable	48,736.54	
Bills receivable	8,940.76	
Machinery at factory	25,780.94	
Unused tools	3,760.92	
Office buildings	5,000.00	
Factory buildings	46,978.60	
Finished goods inventory	25,760.74	
Partly finished goods inventory	16,987.56	
Raw materials inventory	12,879.25	
Factory petty cash fund	800.00	
Bills payable		$ 12,760.00
Vouchers payable		15,621.24
Capital stock		150,000.00
Surplus		22,918.17
	$201,299.41	$201,299.41

During the month of June, 1912, the following transactions occurred:

Factory wages paid $16,798.25. Unclaimed wages amounted to $476.54, which are held at factory until called for. Of the total amount of labor $12,578.22 is direct labor and the balance indirect.

Materials purchased and received for use in factory work amount to $24,254.73. Requisitions on the storekeeper for materials used in manufacture amounted to $18,234.87. Requisitions for materials used in repairs to machinery, shafting, etc., amounted to $756.26.

Special jobs completed and shipped cost to make $28,378.34. Stock orders completed amounted to $5,389.27. Sales of finished goods from stock amounted to $7,342.53.

Factory expenses for insurance, rents, taxes, etc., amounted to $3,897.23. Depreciation on machinery is to be taken care of by setting up a reserve at the rate of 12% per annum.

Show:

1. Journal entry for general books to open factory ledger.
2. All factory ledger accounts as they should appear after the entries for June have been made.
3. Trial balance of factory ledger as at June 30, 1912. (C. P. A.)

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